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No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

APPENDIX TO JURISDICTIONAL STATEMENT

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APPENDIX A

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

S.F. 24591
(Super. Ct. No. 740351)

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed July 18, 1985]

Plaintiff filed this class action to challenge the validity of charges imposed by defendant Crocker National Bank for the processing of checks drawn on accounts without sufficient funds. (The parties refer to such checks as NSF checks and to the handling charge as an NSF charge.) He appeals from a judgment of the trial court entered after that court sustained defendant's general demurrer without leave to amend.

On July 3, 1978, plaintiff filed suit on behalf of all persons with checking accounts at defendant bank and a subclass of customers who have paid NSF charges to the bank.[1] The complaint first alleges a contract under which

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[1] The complaint refers to both "plaintiffs" and "defendants" in the plural. Perdue, however, is the only named plaintiff; the

the bank furnishes checking service in return for a maintenance charge.[2] It then asserts that "It is the practice of defendants to impose and collect a unilateral set charge for processing checks presented against plaintiffs' accounts when such accounts do not contain sufficient funds to cover the amount of the check." "Defendants have at various times unilaterally increased the NSF charge to an amount the defendants deemed appropriate, without reference to any criteria, and defendants imposed and collected the said increased amount without any explanation or justification by defendants to plaintiffs." At the time of filing of the suit, the charge was $6 for each NSF check, whether the check was honored or returned unpaid, even though "the actual cost incurred by the defendants in processing an NSF check is approximately $0.30."

The bank requires each depositor to sign a signature card which it uses "to determine and verify the authenticity of endorsements on checks". A copy of the signature card is attached as an exhibit to the complaint and reproduced in an appendix to this opinion. In extremely small (6 point) type, it states that the undersigned depositors "agree with Crocker National Bank and with each other that . . . this account and all deposits therein shall be . . . subject to all applicable laws, to the Bank's present and future rules, regulations, practices and

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others are unidentified members of the class. The complaint names Crocker National Bank and Does 1-100 as defendants, but the "Doe" defendants have not been served or identified. We refer to both parties in the singular.

[2] Paragraph 7 states: "Defendants offer said checking services in exchange for a promise by plaintiffs to pay a predetermined charge set by defendants [hereafter called the maintenance charge.] Plaintiffs, at the commencement of the checking account agreed to pay said maintenance charge, or to maintain a minimum balance in their checking account or some similar arrangement, unless such charge was waived. . . ."

charges, and to its right of setoff for the obligations of any of us." The card does not identify the amount of the charge for NSF checks, and the bank does not furnish the depositor with a copy of the applicable bank rules and regulations.[3]

On the basis of these allegations, plaintiff asserts five causes of action: (1) for a judicial declaration that the bank's signature card is not a contract authorizing NSF charges; (2) for a judicial declaration that such charges are oppressive and unconscionable; (3) to recover damages for unjust enrichment derived from the bank's collection of illegal NSF charges; (4) to enjoin alleged unfair and deceptive practices—the bank's failure to inform customers of the contractual nature of the signature card, and its practice of waiving NSF charges as to certain preferred customers; and (5) to recover the difference between the NSF charges and defendant's actual expenses in processing NSF checks on the theory that the charges represent an unreasonable attempt to fix liquidated damages.

Defendant filed general and special demurrers to each of the asserted causes of action. The superior court sustained the general demurrers and, taking notice of the fact that plaintiff had filed three previous complaints in another action raising similar issues,[4] denied leave to amend. Plaintiff appeals from judgment for defendant.

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[3] Financial Code section 865.2, effective July 1, 1977, requires banks to make information about bank charges available to the public in an area of the bank open to the public. The complaint does not state whether defendant complied with this section.

[4] Plaintiff Perdue and co-plaintiff Ralph Abascal filed a complaint against Crocker National Bank on March 15, 1977, raising issues similar to those of the present complaint. (S.F. Super. Ct. No. 720-309.) After the court sustained demurrers with leave to amend, Perdue and Abascal filed a first, and then a second amended complaint. On June 15, 1978, counsel for Perdue and counsel for Abascal severed their association, and counsel for Perdue filed the

Plaintiff's third alleged cause of action is derivative; its charge of unjust enrichment depends upon a finding pursuant to some other cause of action that the NSF charges were invalid or excessive. This cause of action raises no issues for decision in the present appeal. The other four alleged causes of action, however, present independent and substantial issues. We review each in turn, applying the established principle that a demurrer "admits the truth of all material factual allegations in the complaint . . .; the question of plaintiff's ability to prove those allegations, or the possible difficulty in making such proof does not concern the reviewing court." (Alcorn v. Anbro Engineering Inc. (1970) 2 Cal.3d 493, 496; Committee on Children's TV, Inc. v. General Foods Corp. (1983) 35 Cal.3d 197, 213-214.)

I. *Plaintiff's first cause of action: whether the signature card is a contract authorizing NSF charges.*

The complaint alleges that "The signature card prepared by the defendants does not identify the amount of any charge to be paid by the plaintiffs for processing NSF checks and is not an agreement for such payment. The card does not constitute mutual assent to NSF charges in any particular sum or at all and accordingly is not a contract conferring authority to do the acts complained of herein." "Based upon the language of the signature card, the plaintiffs believed and expected that the signature card was intended as a handwriting example for purposes of identification and verification only." Plaintiff therefore seeks a judicial declaration "as to whether the signature card is a valid or enforceable contract and . . . a lawful basis for the imposition of the NSF charge."

The cases unanimously agree that a signature card such as the Crocker Bank card at issue here is a con-

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present action. The superior court subsequently denied a petition to coordinate the various actions attacking NSF check charges, and dismissed Perdue as a coplaintiff in action No. 720-309.

tract. "The bank is authorized to honor withdrawals from an account on the signatures authorized by the signature card, which serves as a contract between the depositor and the bank for the handling of the account." (Blackmon v. Hale (1970) 1 Cal.3d 548, 556; Bullis v. Security Pac. Nat. Bank (1978) 21 Cal.3d 801, 811-812.) Other California decisions (see Hoffman v. Security Pacific Nat. Bank (1981) 121 Cal.App.3d 964, 969; Larrus v. First National Bank (1954) 122 Cal.App. 2d 884, 889-890) and decisions of other states (see, e.g., In re Estate of Cilvik (Pa. 1970) 267 A.2d 836, 838, fn. 2) also view the signature card as a contract.

Plaintiff does not seriously dispute this proposition. His complaint alleges that the depositors "agreed to pay [the bank's] maintenance charge . . ." in return for checking privileges, and one could infer that they agreed to do so by affixing their signatures to the card. Complaints filed by plaintiff in an earlier action stated expressly that the signature card was a contract.[5]

Plaintiff argues, however, that even if a signature card is a contract to establish a checking account, it is not a contract authorizing NSF charges. He contends that the contract is illusory because it permits the bank to set and change the NSF charges at its discretion, and without assent from the customer except such as may be inferred from the fact that the customer does not cancel his account after the bank posts notice of its rates.[6]

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[5] The parties dispute whether the language in the complaints filed in action S.F. Super. Ct. No. 720-309 are binding upon plaintiff in the present case. It is well settled that a court may consider language of prior complaints in the same action in ruling on a demurrer (Reichert v. General Ins. Co. (1968) 68 Cal.2d 822, 836), but the cases do not discuss the effect of a prior complaint in a different action.

[6] Financial Code section 865.4, subdivision (b) (1) requires a bank to give customers 15 days' notice of any change in charges imposed on bank accounts.

Plaintiff relies on the rule that "[a]n agreement that provides that the price to be paid, or other performance to be rendered, shall be left to the will and discretion of one of the parties is not enforceable." (Automatic Vending Co. v. Wisdom (1960) 182 Cal.App.2d 354, 357.) That rule, however, applies only if the total discretion granted one party renders the contract lacking in consideration. (See *ibid.*) If there are reciprocal promises, as in the present case, the fact that the contract permits one party to set or change the price charged for goods or services does not render the contract illusory. Thus in Cal. Lettuce Growers v. Union Sugar Co. (1955) 45 Cal.2d 474, the court upheld a contract permitting the buyer of sugar beets to set the price to be paid. The buyer did not have arbitrary power, the court explained, because "where a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing." (P. 484; see Automatic Vending Co. v. Wisdom, *supra*, 182 Cal.App.2d 354, 358 and cases there cited; cf. Civ. Code, § 1611; Cal. U. Com. Code, § 2305; 1 Corbin, Contracts (1963 ed.) § 98.) Likewise, "a contracting party's discretionary power to vary the price or other performance does not render the agreement illusory if the party's *actual* exercise of the power is reasonable." (Powell v. Central Cal. Fed. Sav. & Loan Assn. (1976) 59 Cal.App.3d 540, 549, italics original; see Vanguard Investments v. Central Cal. Fed. Sav. & Loan Assn. (1977) 68 Cal.App.3d 950, 958; Frankini v. Bank of America (1939) 31 Cal.App.2d 666, 676.)

The recent decision in Lazar v. Hertz Corp. (1983) 143 Cal.App.3d 128, offers an analogy to the present litigation. Hertz' car rental agreement permitted it to determine unilaterally the price charged for gas used to fill the tanks of returned rental cars. Plaintiff's suit alleged that Hertz fixed unreasonably high prices, in

breach of its duty of good faith and fair dealing. Discussing this cause of action, the court said that "[t]he essence of the good faith covenant is objectively reasonable conduct. Under California law, an open term in a contract must be filled in by the party having discretion within the standard of good faith and fair dealing." (P. 141.)

We conclude that plaintiff here is not entitled to a judicial declaration that the bank's signature card is not a contract authorizing NSF charges. To the contrary, we hold as a matter of law that the card is a contract authorizing the bank to impose such charges, subject to the bank's duty of good faith and fair dealing in setting or varying such charges. Plaintiff may, upon remand of this case, amend his complaint to seek a judicial declaration determining whether the charges actually set by the bank are consonant with that duty.

II. *Plaintiff's second cause of action: whether the bank's NSF charges are oppressive, unreasonable, or unconscionable.*

Plaintiff's second cause of action alleges that the signature card is drafted by defendant bank which enjoys a superior bargaining position by reason of its greater economic power, knowledge, experience and resources. Depositors have no alternative but to acquiesce in the relationship as offered by defendant or to accept a similar arrangement with another bank.[7] The complaint alleges that the card is vague and uncertain, that it is unclear whether it is intended as an identification card or a contract, that it imposes no obligation upon the bank, and permits the bank to alter or terminate the relationship at

[7] Defendant and other banks now offer some depositors an arrangement under which, for a fee, the bank will treat NSF checks up to a certain amount as credit card transactions, and honor such checks. We do not know whether such arrangements were available when plaintiff filed his complaint.

any time.[8] It then asserts that "The disparity between the actual cost to defendants and the amount charged by defendants for processing an NSF check unreasonably and oppressively imposes excessive and unfair liability upon plaintiffs." Plaintiff seeks a declaratory judgment to determine the rights and duties of the parties.

Plaintiff's allegations point to the conclusion that the signature card, if it is a contract, is one of adhesion. The term contract of adhesion "signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (Neal v. State Farm Ins. Co. (1961) 188 Cal.App.2d 690, 694; Graham v. Scissor-Tail, Inc. (1981) 28 Cal.3d 807, 817.) The signature card, drafted by the bank and offered to the customer without negotiation, is a classic example of a contract of adhesion; the bank concedes as much.

In Graham v. Scissor-Tail, Inc., *supra*, 28 Cal.3d 807, we observed that "To describe a contract as adhesive in character is not to indicate its legal effect . . . . [A] contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (Pp. 819-820, fn. omitted.) "Generally speaking," we explained, "there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if

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[8] The depositor also has the right to terminate the relationship at any time, but lacks the right asserted by the bank to alter the relationship without terminating it.

consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' " (P. 820, fns. omitted.)[9]

In 1979, the Legislature enacted Civil Code section 1670.5, which codified the established doctrine that a court can refuse to enforce an unconscionable provision in a contract.[10] Section 1670.5 reads as follows: "(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. [¶] (b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be af-

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[9] The Court of Appeal decision in A & M Produce Co. v. FMC Corp. (1982) 135 Cal.App.3d 473, offers an alternative analytical framework. It treats "unconscionability" as the only basis for refusing to enforce a provision. (Graham v. Scissor-Tail, Inc., *supra*, 28 Cal.3d 807, spoke of "frustration of reasonable expectations" and "unconscionability" as alternative bases for refusing enforcement.) *A & M Produce* then divided the analysis of unconscionability into two elements—procedural and substantive. The procedural element included "oppression" arising from unequal bargaining power and "surprise" arising from the assertion of hidden and unexpected provisions. The substantive element involved consideration of whether the provision was one-sided, unreasonable, and lacked justification. (See 135 Cal.App.3d at pp. 485-487.)

Graham v. *Scissor-Tail, Inc.* comports somewhat more closely to the California precedent; *A & M Produce* conforms more closely to the Uniform Commercial Code and the cases decided under that code. Both pathways should lead to the same result.

[10] Section 1670.5 is based upon Uniform Commercial Code section 2-302, but expands coverage to include noncommercial contracts. For review of the legislative history of section 1670.5, see IMO Development Corp. v. Dow Corning Corp. (1982) 135 Cal.App.3d 451, 459-460.

forded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination."

In construing this section, we cannot go so far as plaintiff, who contends that even a conclusory allegation of unconscionability requires an evidentiary hearing. We do view the section, however, as legislative recognition that a claim of unconscionability often cannot be determined merely by examining the face of the contract, but will require inquiry into its setting, purpose, and effect.

Plaintiff bases his claim of unconscionability on the alleged 2,000 percent differential between the NSF charge of $6 and the alleged cost to the bank of $0.30.[11] The parties have cited numerous cases on whether the price of an item can be so excessive as to be unconscionable. The cited cases are from other jurisdictions, often from trial courts or intermediate appellate courts, and none is truly authoritative on the issue. Taken together, however, they provide a useful guide to analysis of the claim that a price is so excessive as to be unconscionable.

To begin with, it is clear that the price term, like any other term in a contract, may be unconscionable. (Patterson v. Walker-Thomas Furniture Co. (D.C.Ct. App. 1971) 277 A.2d 111, 113 and cases there cited (fn. 6); see Central Budget Corp. v. Sanchez (N.Y. City Civ. Ct. 1967) 279 N.Y.Supp.2d 391, 392; Merrel v. Research & Data, Inc. (Kan.Ct.App. 1979) 589 P.2d 120, 123 (dictum); Vom Lehn v. Astor Art Galleries, Ltd. (N.Y. Sup. Ct. 1976) 380 N.Y.Supp.2d 532, 541.) Allegations

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[11] The bank's briefs claim the alleged $0.30 cost is too low and plaintiff's briefs admit that a higher figure, but still $1 or less, might be more accurate. We do not, however, find in plaintiff's briefs a sufficiently clear concession to enable us to depart from the general principle that, in reviewing a judgment after the sustaining of a general demurrer without leave to amend, we must assume the truth of all material factual allegations in the complaint. (Alcorn v. Anbro Engineering, Inc., *supra*, 2 Cal.3d 493, 496.)

that the price exceeds cost or fair value, standing alone, do not state a cause of action. (Morris v. Capitol Furniture Co. (App. D.C. 1971) 280 A.2d 775 [100 percent markup over cost]; Patterson v. Walker-Thomas Furniture Co., *supra*, 277 A.2d 111, 114 [price alleged to be in excess of fair value]; Bennett v. Behring Corp. (S.D. Fla. 1979) 466 F.Supp. 689, 696-698 [price in excess of value].) Instead, plaintiff's case will turn upon further allegations and proof setting forth the circumstances of the transaction.

The courts look to the basis and justification for the price (cf. A & M Produce Co. v. FMC Corp., *supra*, 135 Cal.App.3d 473, 487), including "the price actually being paid by . . . other similarly situated consumers in a similar transaction." (Bennett v. Behring Corp., *supra*, 466 F.Supp. 689, 697, italics omitted.) The cases, however, do not support defendant's contention that a price equal to the market price cannot be held unconscionable. While it is unlikely that a court would find a price set by a freely competitive market to be unconscionable (see Bradford v. Plains Cotton Cooperative Assn. (10th Cir. 1976) 539 F.2d 1249, 1255 [cotton futures]), the market price set by an oligopoly should not be immune from scrutiny. Thus courts consider not only the market price, but also the cost of the goods or services to the seller (Frostifresh Corporation v. Reynoso (N.Y. Dist. Ct. 1966) 274 N.Y.Supp. 757; Toker v. Westerman (N.J. 1970) 274 A.2d 78), the inconvenience imposed on the seller (see Merrel v. Research & Data, Inc., *supra*, 589 P.2d 120, 123), and the true value of the produce [sic] or service (American Home Improvements, Inc. v. MacIver (N.H. 1964) 201 A.2d 886, 889).

In addition to the price justification, decisions examine what Justice Weiner in *A & M Produce* called the "procedural aspects" of unconscionability. (See *A & M Produce Co.*, *supra*, at p. 489.) Cases may turn on the absence of meaningful choice (Patterson v. Walker-

Thomas Furniture Co., *supra*, 277 A.2d 111, 113 and cases there cited), the lack of sophistication of the buyer (compare Geldermann & Co., Inc. v. Lane Processing, Inc. (8th Cir. 1975) 527 F.2d 571, 576 [relief denied to sophisticated investor) with Forstifresh Corporation v. Reynoso, *supra*, 284 N.Y.Supp.2d 757 [relief granted to unsophisticated buyers]) and the presence of deceptive practices by the seller (*ibid.;* Vom Lehn v. Astor Art Galleries, Ltd., *supra*, 380 N.Y.Supp.2d 532).

Applying this analysis to our review of the complaint at hand, we cannot endorse defendant's argument that the $6 charge is so obviously reasonable that no inquiry into its basis or justification is necessary.[12] In 1978 $6 for processing NSF checks may not seem exorbitant,[13]

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[12] In Jacobs v. Citibank, N.A. (1984) —— N.Y. ——, the New York Court of Appeals upheld a summary judgment for defendant bank in a suit attacking NSF check charges. In rejecting the claim that such charges were unconscionable, the court said that "[p]laintiffs have failed to show that they were deprived of a meaningful choice of banks with which they could do business and that the terms of these agreements with defendant were unreasonably favorable to the bank." (P. ——.)

While the New York court ruled on a motion for summary judgment, we rule upon a demurrer, and look only to plaintiff's allegations, not to the proof he had advanced to support those allegations. Plaintiff here has alleged that the charges imposed by defendant bank were excessive, and that similar arrangements would be imposed by other banks. Such allegations, which we must assume to be true, distinguish the New York decision.

[13] Defendant cites Merrel v. Research & Data, Inc., *supra*, 589 P.2d 120, which held a $5 fee imposed by merchants for NSF checks was a "modest" amount (p. 123) and not unconscionable. NSF checks pose a substantial inconvenience to a seller, who has been deceived into an involuntary extension of credit to a customer whose credit standing may not be very good. A bank, however, is not deceived. It checks the balance of the account, and may reject any overdraft. A fee reasonable to compensate the merchant for the cost, inconvenience, and risk of an NSF check may be excessive if exacted by a bank.

but price alone is not a reliable guide. Small charges applied to a large volume of transactions may yield a sizable sum. The complaint asserts that the cost of processing NSF checks is only $0.30 per check, which means that a $6 charge would produce a 2,000 percent profit; even at the higher cost estimate of $1 a check mentioned in plaintiff's petition for hearing, the profit is 600 percent.[14] Such profit percentages may not be automatically unconscionable, but they indicate the need for further inquiry.[15]

Other aspects of the transaction confirm plaintiff's right to a factual hearing. Defendant presents the depositor with a document which serves at least in part as a handwriting exemplar, and whose contractual character is not obvious. The contractual language appears in print so small that many could not read it. State law may impose obligations on the bank (e.g., the duty to honor a check when the account has sufficient funds (Allen v. Bank of America, *supra*, 58 Cal.App.2d 124, 127)), but so far as the signature card drafted by the bank is concerned, the bank has all the rights and the depositor all the duties. The signature card provides that the depositor will be bound by the bank's rules, regulations, practices and charges, but the bank does not furnish the depositor with a copy of the relevant documents. The bank reserves the power to change its practices and fees at any time, subject only to the notice requirements of state law.

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[14] The complaint does not state the market price for the service of processing NSF checks, although one might infer it is similar to defendant's price since plaintiff alleges that if he did not contract with defendant, he would be "forced to accept a similar arrangement with other banks." The complaint does not set a figure for the "fair" or "true" value or worth of the service.

[15] We observe that the bank charges the same fee whether it honors or rejects an NSF check. The fee, consequently, cannot be intended as compensation for the credit risk arising from paying such a check, or for the interest on the amount loaned.

In short, the bank structured a totally one-sided transaction. The absence of equality of bargaining power, open negotiation, full disclosure, and a contract which fairly sets out the rights and duties of each party demonstrates that the transaction lacks those checks and balances which would inhibit the charging of unconscionable fees. In such a setting, plaintiff's charge that the bank's NSF fee is exorbitant, yielding a profit far in excess of cost, cannot be dismissed on demurrer. Under Civil Code section 1670.5, the parties should be afforded a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect of the signature card and the NSF charge in order to determine whether that charge is unconscionable.

III. *Plaintiff's fourth cause of action: whether the bank has performed acts of unfair competition.*

Business and Professions Code section 17200 defines "unfair competition" to include any "unlawful, unfair, or fraudulent business practice." This language is intended to protect consumers as well as business competitors; its prohibitory reach is not limited to deceptive or fraudulent conduct but extends to any unlawful business conduct. (Committee on Children's TV, Inc. v. General Foods Corp., *supra*, 35 Cal.3d 197, 209-210; Stoiber v. Honeychuck (1980) 101 Cal.App.3d 903, 927.)

The complaint charges two acts of unfair competition. First, it asserts that the "signature card is used in a manner which is unfair, deceptive and misleading, in that plaintiffs are led to believe that it is a signature card for identification purposes and the defendants treat the signature card, without disclosure of said fact, as the legal authority to impose the NSF charge on plaintiffs' checking accounts." Second, it asserts that "defendants arbitrarily and capriciously waive the NSF charge for preferred or commercial accounts," thus shifting the costs of processing NSF checks from those preferred customers to others whose accounts are charged.

Neither allegation is clear and precise. After reading paragraph 38, we are uncertain whether plaintiff contends that the signature card itself is deceptive, or whether he contends that the bank employs misrepresentations or other deceptive practices in presenting the card to the depositor. If the latter is plaintiff's contention, the complaint should set out the challenged representations or practices.

It is, of course, clear that if plaintiff can show that the card or the manner in which it is presented to the customer is deceptive and misleading, he can prove a cause of action for unfair competition. Since he seeks only injunctive relief under this cause of action, he need not show that he himself was misled; he need only prove that "members of the public are likely to be deceived." (Chern v. Bank of America (1976) 15 Cal.3d 866, 876; Committee on Children's TV, Inc. v. General Foods Corp., *supra*, 35 Cal.3d 197, 211.) Thus the defect in plaintiff's allegation is not one of substance, but only of lack of certainty. Such a defect would not justify the sustaining of a demurrer without leave to amend. (Minsky v. City of Los Angeles (1974) 11 Cal.3d 113, 118; La Sala v. American Sav. & Loan Assn. (1971) 5 Cal.3d 864, 876.)

Plaintiff's assertion in paragraph 39 that the bank arbitrarily waives NSF charges for some customers contains a more serious defect. Although price discrimination is often unlawful, depending upon the context of the act and the intent of the perpetrator (see the Unfair Practices Act, Bus. & Prof. Code, § 17000 et seq.), "arbitrary" price discrimination in itself is not necessarily illegal. This defect is one of substance; while plaintiff's accusation in paragraph 38 of deceptive and misleading practices describes acts of unfair competition, albeit in very general terms, his accusation of arbitrary waiver of NSF charges does not.

Plaintiff could amend his complaint to add particulars which would show that the bank's discriminatory waiver

of NSF charges violated some legal requirement. We are disturbed, however, that plaintiff has never advanced any theory under which the waiver would constitute unfair competition. Plaintiff has argued only that the waiver of NSF charges as to some customers shifts the processing costs to others. Even if true, that allegation would not suffice to prove unfair competition.

In conclusion, the superior court properly sustained a demurrer to plaintiff's fourth cause of action, but erred in denying leave to amend. Plaintiff should be permitted to amend to set out the alleged deceptive practices employed by defendant. The trial court would be within its discretion in denying leave to amend to claim unlawful discrimination in waiving NSF charges, but since plaintiff must be allowed to amend on the deceptive practices issue, the court may choose to permit amendment as to the waiver issue as well.

IV. *Plaintiff's fifth cause of action: whether the bank's charge for NSF checks is an unlawful penalty.*

Paragraph 42 of the complaint states that "[c]ausing NSF checks to be presented for payment is a breach by plaintiffs of their contractual obligations to defendant . . . ." The NSF charge collected by defendants, however, "is a penalty and is not imposed to compensate defendants for damages incurred by plaintiffs' breach", and therefore violates Civil Code sections 1670 and 1671. The complaint concludes that "[p]laintiffs are entitled to recover the difference between the unlawful charges collected and defendants' actual damages . . . ."

By these allegations, plaintiff seeks to invoke the rule that a contractual provision specifying damages for breach is valid only if it "represent[s] the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sus-

tained." (Better Food Mkts. v. Amer. Dist. Teleg. Co. (1953) 40 Cal.2d 179, 187; Garrett v. Coast & Southern Fed. Sav. & Loan Assn., *supra*, 9 Cal.3d 731, 739.) An amount disproportionate to the anticipated damages is termed a "penalty." A contractual provision imposing a "penalty" is ineffective, and the wronged party can collect only the actual damages sustained.[16]

Two Court of Appeal decisions have addressed plaintiff's contention and concluded that the writing of an NSF check is not a breach of contract, and thus the fee charged for processing the check is not a penalty.[17] In Hoffman v. Security Pacific Nat. Bank (1981) 121 Cal. App.3d 964, 968-969, the court said that "[p]laintiff argued, and attempted to prove, that the depositors entered into a covenant not to write NSF checks when they

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[16] In Garrett v. Coast Southern Fed. Sav. & Loan Assn., *supra*, 9 Cal.3d 731, the leading case, we considered a provision which imposed a charge for late payment of installments due under a trust deed, but computed that charge as a percentage of the unpaid principal balance. Defendant savings and loan association contended that the provision did not impose a penalty for breach of obligation, but offered borrowers an alternative method for performing their obligation.

We concluded, however, that "the only reasonable interpretation of the clause providing for imposition of an increased interest rate is that the parties agreed upon the rate which should govern the contract and then, realizing that the borrowers might fail to make timely payment, they further agreed that such borrowers were to pay an additional sum as damages for their breach which sum was determined by applying the increased rate to the entire unpaid principal balance. Inasmuch as this increased interest charge is assessed only upon default, it is invalid unless it meets the requirements of section 1671. [Citations.]" (P. 738.) We held that the liquidated damages provision was invalid because it calculated damages on the basis of the entire unpaid balance, not on the basis of the amount of the overdue installment or the cost to the defendant. (P. 740.)

[17] A New York decision, Jacobs v. Citibank, N.A., *supra*, —— N.Y. ——, —— reached the same conclusion.

executed signature cards . . . . Plaintiff attempted to show that industry custom prohibited the writing of overdrafts without prior agreement and that the depositors' promise to pay a service charge for any NSF check contained an implied covenant not to write such checks. [¶] Plaintiff failed to establish any such custom or any agreement on the depositors' part not to write overdrafts. Moreover, statutes governing the obligations of banks and their depositors, which are incorporated into and become part of the contract between a bank and its depositors [citations], treat an overdraft as an application for advance credit rather than as a breach of an express or implied covenant. California Uniform Commercial Code section 4401 specifically authorizes a bank to pay overdafts and to charge customers' accounts to recover amounts paid, even when payments result in overdrafts on the account. While a bank has a statutory obligation to honor any check drawn by a depositor for an amount not exceeding the balance in his account, and while the depositor has a contractual obligation to pay a service charge when he presents a NSF check, the depositor has no statutory or contractual obligation to refrain from drawing checks for amounts in excess of the balance in his account. (Cal. U. Com. Code, § 4401.)" (Pp. 968-969; accord, Shapiro v. United California Bank (1982) 133 Cal.App.3d 256, 262.)

We cannot entirely agree with *Hoffman* and *Shapiro* that the contract between the bank and the depositor treats an overdraft as an application for advance credit. The contract in fact is silent on the characterization of an NSF check, and the bank is aware that a depositor often writes overdrafts in the mistaken belief that he has, or will have, sufficient funds to cover the check, and without any intent to apply for credit.[18] We agree with

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[18] Contrary to the contention of the bank, such overdrafts are not necessarily the result of carelessness by the depositor; they may be the result of bank delay in crediting a deposit or of bank dis-

those decisions, however, that because the depositor has never agreed to refrain from writing NSF checks, the writing of such a check is not a breach of contract. The fee that the bank may charge for processing such a check is limited by principles of good faith, reasonableness, unconscionability, and the like, but it is not limited to the amount which a bank could recover in a suit for breach of contract. We conclude that the court correctly sustained the demurrer to plaintiff's fifth cause of action without leave to amend.

V. *Whether California law, as applied to NSF charges imposed by national banks, is preempted by federal law.*

Defendant contends that the provisions of California law on which plaintiff bases his causes of action are preempted by federal law. Since we have concluded that plaintiff's complaint states no cause of action for recovery of penalties under Civil Code section 1671, we do not discuss whether federal law preempts application of that section to banking charges. Instead, we focus our discussion on whether California law is preempted to the extent that it prohibits banks from exacting unreasonable charges (a doctrine applicable only when the contract does not expressly fix the charge) or enforcing unconscionable provisions (a doctrine applicable to all contracts).[19]

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honor of an NSF check submitted for deposit under a reasonable belief that the check was good.

[19] We note preliminarily that defendant appears to assume that if state law is preempted, federally chartered banks are free to enforce unconscionable contracts. We question that assumption; we believe that a federal court, deciding federal common law, might choose to follow the lead of the state courts and legislatures and limit the power of banks to enforce oppressive contracts. In particular, we suggest that the provisions of the Uniform Commercial Code, now in effect in 49 states, express a national consensus that courts should have the power to avoid unfair and

No provision of federal law discusses bank charges for NSF checks, or, for that matter, bank charges for any service performed for depositors. No federal statute considers whether provisions in contracts between banks and their customers may exact unreasonable or unconscionable fees. Defendant's preemption argument, consequently, is essentially an argument that even though the federal government has largely declined to regulate this area,[20] Congress has nevertheless decided to preclude state regulation.

Defendant cites various statutes and a newly promulgated administrative regulation as a basis for preemption. First, it refers to the National Bank Act of 1864, 13 Statutes at Large 99. Section 24 of this act (12 U.S.C. § 24) grants national banks general corporate powers upon proper filing of articles of association and an organizational certificate. Paragraph 7 empowers the board of directors or duly authorized officers or agents to exercise "all such incidental powers as shall be necessary to carry on the business of banking . . . by receiving deposits . . . ." Defendant asserts that the power to receive deposits necessarily includes the power to control related charges, and hence that such charges are exempt from state law. Amicus California Bankers Association also points to the statutory requirement that bank directors refrain from any "unsafe or unsound practice" (12 U.S.C. § 1818(e)), and argues that a

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oppressive contractual provisions. We need not decide questions of federal common law, however, because we have concluded that absent an evidentiary showing that the challenged state laws will impair the efficiency of national banks or their ability to perform their duties—which showing cannot be made by demurrer—federal law asserts no preemptive effect in this case.

[20] The Comptroller of the Currency could enjoin a bank service charge, or any other act of a national bank, which he considered an unsafe or unsound practice. (12 U.S.C. § 1818(b).) To our knowledge, this authority has never been used to curb excessive bank charges.

charge for NSF checks low enough to avoid an attack as unconscionable or penal might be inadequate to discourage the writing of such checks, and thus constitute an unsound practice.[21]

Next, defendant cites the Depository Institutes [sic] Deregulation and Monetary Control Act of 1980, 94 Statutes 132 (hereafter 1980 Act) and the Garn-St. Germain Depository Institutions Act of 1982, 96 Statutes at Large 1469 (hereafter 1982 Act). The 1980 and 1982 Acts aimed at the gradual removal of federal regulations limiting the interest banks could pay to depositors. The 1980 Act also preempted state usury laws to the extent that they limited the interest banks could collect on mortgages, but left intact state limits on other loan charges. Apart from that provision, neither act expressly preempts state law; neither discusses bank charges for NSF checks or other depositor services. Defendant nevertheless argues that Congress contemplated that after deregulation, banks would pay higher interest to depositors,

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[21] Defendant also cites 12 United States Code section 484, which provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law." Cases construing this section do not make clear when an unauthorized person or agency may, without violating this section, examine bank records for a limited purpose. (Compare Guthrie v. Harkness (1905) 199 U.S. 148, 157-159 [stockholder may inspect to determine the value of his stock] and Peoples Bank of Danville v. Williams (D.Va. 1978) 449 F.Supp. 254, 259-260 [Securities Exchange Commission may inspect to detect fraud in sale of bank stock] with National State Bank, Elizabeth N.J. v. Long (3d Cir. 1980) 630 F.2d 981, 989 [state commissioner may not inspect to enforce law against "redlining"].) Thus, it is possible that section 484 may serve to limit plaintiff's ability to examine records by way of discovery, or to subpoena such records at trial. Difficulties in proof, however, are irrelevant in ruling upon a demurrer. Since the bank can comply with California law without violating section 484, and plaintiff can state a cause of action for violation of such law without violating section 484, we find no present conflict between state law and section 484. Plaintiff will simply have to prove his case without using methods which violate that section.

and raise charges for services previously subsidized by the below-market interest rates on deposit accounts. Further, defendant claims Congress intended such charges to be set in a competitive market free of regulation.

Finally, defendant relies on a regulation promulgated by the Comptroller of the Currency just prior to argument in the present case.[22] The new regulation, effective December 2, 1983, amends 12 Code of Federal Regulations section 7.8000, which previously provided only that "[a]ll charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or even discussion among banks or their officers." As subsequently amended March 10, 1984, the new regulation adds subdivisions (b) and (c) to section 7.8000, to read as follows:

"(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness. In establishing deposit account service charges, the bank may consider, but is not limited to considering: [¶] (1) Costs incurred by the bank, plus a profit margin, in providing the service; [¶] (2) The deterrence of misuse by customers of banking services; [¶] (3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy; [¶] (4) Maintenance of the safety and soundness of the institution.

"(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the

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[22] Plaintiff charges that this regulation was promulgated to influence the decision of the court in the present case. We find no impropriety in an administrative agency issuing a regulation to clarify its position on contested issues in pending litigation.

amount of that charge. Such state laws are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks." [23]

The parties dispute whether the regulation is legislative or interpretative in character.[24] Plaintiff contends that it is legislative, and hence invalid because the Comptroller failed to comply with the notice and hearing re-

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[23] The regulation as promulgated on November 28, 1983, differed from the present version in two respects. First, subdivision (b), after stating that the setting of deposit account charges is a business decision made by each bank, added "and the Office will not substitute its judgment." According to the statement published in connection with the March 1984 amendment, this language was eliminated to avoid the implication that the Comptroller would not review bank service charges to determine whether they represented sound banking practice. (See 49 Fed. Reg. 28237 (July 11, 1934).) Second, former subdivision (c) asserted that state laws limiting banking service charges "impair the efficiency of national banks and conflict with the regulatory scheme governing the national banking system and are preempted by federal law." The present regulation asserts that such state laws "are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks." According to the Comptroller's statement, the language was changed to avoid any inference that the regulation itself, and not the statutes it purports to interpret, preempted state law. (*Ibid.*) We note, however, that the March amendment also changes the basis for preemption from the actual effect of state laws upon the federal program to the claim that the federal statutory scheme so occupies the field as to exclude state regulation.

[24] "Generally speaking, it seems to be established that 'regulations,' 'substantive rules' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means." (Gibson Wine Co. v. Snyder (D.C.Cir. 1952) 194 F.2d 329, 331.) Interpretative "rules are essentially hortatory and instructional. . . . By merely clarifying the law's terms as applied situationally, interpretative or administrative-type rules are used more for discretionary fine-tuning than for general law making." (Alcarez v. Block (9th Cir. 1984) 746 F.2d 593, 613.)

quirements of the Administrative Procedure Act (5 U.S.C. § 553). Defendant maintains that it falls within the Administrative Procedure Act's exception for "interpretive rules" (5 U.S.C. § 553(b)(3)(A)).[25] As an interpretative regulation, section 7.8000 would be en-

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[25] "The APA's prescription of notice and comment procedures for agency rulemaking, 5 U.S.C. § 553, together with its broad definition of what amounts to a 'rule', U.S.C. § 551(4), reflect a commitment 'to reintroduce public participation and fairness to affected parties after governmental authority has been delegated to unrepresentative agencies.' Batterton v. Marshall, 648 F.2d 694, 703 (D.C.Cir. 1980) (footnote omitted). Among the limited exceptions to the general notice and comment requirement is the exemption for 'interpretive rules,' 5 U.S.C. § 553(b)(3)(A). This exemption, like the others, is to be narrowly construed. Humana of South Carolina, Inc. v. Califano, 590 F.2d 1070, 1082 (D.C.Cir. 1978)." (Credit Union National Association v. National Credit Union Administration Board (D.D.C. 1983) 573 F.Supp. 586, 591.)

Consequently, the Comptroller's decision to characterize his regulation as interpretative is not dispositive. (Columbia Broadcasting System, Inc. v. United States (1942) 316 U.S. 407, 416; Louisiana-Pacific Corp. v. Block (9th Cir. 1982) 694 F.2d 1205, 1210; Credit Union National Association v. National Credit Union Administration Board, *supra*, 573 F.Supp. 586, 591.) Courts inquire also into the function of the regulation in the administrative structure (see British Caledonian Airways, Ltd. v. C.A.B. (D.C.Cir. 1978) 584 F.2d 982, 994; Joseph v. United States Civil Service Commission (D.C.Cir. 1977) 554 F.2d 1140, 1153), and into its foreseeable effect (Louisiana-Pacific Corp. v. Block, *supra*, 694 F.2d 1205, 1210; Chamber of Commerce of United States v. O.S.H.A. (D.C.Cir. 1980) 636 F.2d 464, 469). It appears now to be generally agreed that proof that a regulation will have a "substantial impact" is not itself sufficient to require classifying that regulation as legislative in character, but that such impact is a proper factor for judicial consideration. (See Cabias v. Egger (D.C.Cir. 1982) 690 F.2d 234, 237.)

There is one exception to the foregoing principles: if the agency labels the regulation as legislative and promulgates it in accord with the requirements of the Administrative Procedure Act, then the regulation has the authority of a legislative rule even though it arguably constitutes only an interpretation of statutory law. (Cf. Levesque v. Block (1st Cir. 1983) 723 F.2d 175, 181-182.)

titled to consideration and weight, but would not be binding on the courts.[26]

We now turn to the question whether the foregoing statutes preempt application of California law in the case at bar. As the United States Supreme Court explained

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[26] Interpretative rules, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a [ruling] in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." (Skidmore v. Swift & Co. (1944) 323 U.S. 134, 140; General Electric Co. v. Gilbert (1976) 429 U.S. 125, 141-142.)

Other cases note that greater weight is given to an interpretation by an agency charged with the duty of administering the statute in question (Red Lion Broadcasting Co. v. FCC (1969) 395 U.S. 367, 381), particularly if the agency took part in the formulation of the statute (Miller v. Youakim (1979) 440 U.S. 125, 144), promulgated its interpretation contemporaneously with the enactment of the statute (see General Electric Co. v. Gilbert, *supra*, 429 U.S. 125, 142), or represents a consistent administrative construction of the act (*id.*). In the present case, these factors fall on both sides of the line. The Comptroller is charged with the execution of the relevant statutes. He took part in the drafting of the 1980 and 1982 Acts, and issued the regulation within a short time of the enactment of the later act. The regulation, on the other hand, is plainly not contemporaneous with the enactment of the National Bank Act. It does not represent a consistent administrative interpretation, since previous actions by the office of the Comptroller have not taken a consistent stand. (Defendant calls our attention to a letter from the Comptroller to the Chairman of the Legal and Monetary Affairs Subcommittee of the House of Representatives Committee on Governmental Affairs, dated Nov. 5, 1963, stating a preference for bank service charges set by free competition instead of local regulation. The letter does not purport to be interpreting existing statutes, or suggest that those statutes, without supplementary legislation, preempt state regulation. Plaintiff refers to an Aug. 27, 1977, letter from the Legal Advisory Services Division of the Comptroller's office stating that state limitations on service charges are not preempted.)

in Silkwood v. Kerr-McGee Corp. (1984) —— U.S. —— [52 U.S. L. Week 4043], "state law can be preempted in either of two general ways. If Congress evidences an intent to occupy a given field, any state law falling within that field is preempted. [Citations.] If Congress has not entirely displaced state regulation over the matter in question, state law is still preempted to the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law [citation], or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress . . ." (—— U.S. at p. —— [52 U.S. L. Week at p. 4046]; accord, Pac. Gas & Electric v. St. Energy Resources Conserv. (1984) —— U.S. ——, —— [103 S.Ct. 1713, 1722].) Defendant bears the burden of persuasion on this issue; "[c]ourts are reluctant to infer preemption, and it is the burden of the party claiming Congress intended to preempt state law to prove it." (Elsworth v. Beech Aircraft Corp. (1984) 37 Cal.3d 540, 548 and cases there cited.)

Defendant contends that Congress, by comprehensive regulation, has occupied the field of regulation of contracts between national banks and their depositors. One hundred and fifteen years of practice under the national banking system argue to the contrary. While nationally chartered banks are subject to the paramount authority of the United States,[27] Congress has declined to provide an entire system of federal law to govern every aspect

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[27] Davis v. Elmira Savings Bank (1896) 161 U.S. 275, 283. Under our dual banking system, commercial banks have the option of being federally or state chartered. Federally chartered (national) banks are governed by the National Bank Act of 1874 [sic] (12 U.S.C. § 21 et seq.) which sets forth chartering criteria, basic banking and investment powers, lending and borrowing limitations, and corporate powers and duties. As required members of the Federal Reserve System and insured of the Federal Deposit Insurance Corporation (FDIC), national banks are also subject to the Federal Reserve Act (12 U.S.C. §§ 221-530), and the FDIC Act (12 U.S.C. § 1811 et seq.).

of national bank operations. Consequently, national banks have traditionally been "governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws." (National Bank v. Commonwealth (1869) 76 U.S. (9 Wall) 353, 362; see Scott, *The Dual Banking System: A Model of Competition in Regulation* (1977) 30 Stan. L. Rev. 1.)[28] As explained in National State Bank, Elizabeth, N.J. v. Long (3d Cir. 1980) 630 F.2d 981, "[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863. . . . In only a few instances has Congress explicitly preempted state regulation of national banks. More commonly, it has been left to the courts to delineate the proper boundaries of federal and state supervision. [¶] The judicial test has been a tolerant one. [National banks'] right to contract, collect debts, and acquire and transfer property are all based on state law." (P. 985.) Thus the rule is that state laws apply, "the exception being the cessation of the operation of such laws whenever they expressly [29] conflict with the laws of the United States or frustrate the purpose for which national banks were created, or impair their efficiency to discharge [their] duties . . . ." (McClellan v. Chipman (1896) 164 U.S. 347, 357.)[30]

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[28] Courts have routinely applied state contract law in cases involving national banks. See, e.g., Wichita Eagle & Beacon Publishing Co. Inc. v. Pacific Nat'l Bank (9th Cir. 1974) 493 F.2d 1285; Fowler v. Security First National Bank (1956) 146 Cal.App. 2d 37; Security First National Bank v. Rospaw (1951) 107 Cal. App.2d 220.

[29] The Supreme Court has at times preempted state law on the basis of an implied, rather than an express, conflict. (Compare, Franklin Nat'l Bank v. New York (1954) 347 U.S. 373 with Davis v. Elmira Savings Bank, *supra*, 161 U.S. 275.)

[30] This rule has been consistently followed over the years. Lewis v. Fidelity & Deposit Co. (1934) 292 U.S. 559, 566; First Nat'l

The assertion in the regulation that state laws limiting bank service charges "are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks" (12 C.F.R. § 7.8000, subd. (c)) is palpably erroneous. There is no comprehensive federal statutory scheme governing the taking of deposits. There is one relevant statute, section 24 of the National Bank Act, and that merely authorizes banks to accept deposits. Section 24 may by implication also authorize banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits, but such implied authority does not constitute a regulatory scheme so comprehensive as to displace state law.[31]

Under the Comptroller's interpretation, any banking matter related to deposits would be exempt from state law. The result would be far-reaching and extremely disruptive. Currently, California and most other states extensively regulate all banks within their territory. For example, article 4 of the Uniform Commercial Code (codified at Cal. U. Com. Code, §§ 4101-4407), entitled

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Bank v. Missouri (1923) 263 U.S. 640; Nat'l. State Bank v. Long (3d Cir. 1980) 630 F.2d 981, 985-986; Brown v. United Community Nat'l Bank (D.D.C. 1968) 282 F.Supp. 781, 783; South Dakota v. Nat'l Bank (D.S.D. 1963) 219 F.Supp. 842, 844-845, affirmed (8th Cir. 1964) 335 F.2d 444, certiorari denied (1965) 379 U.S. 970. The test has sometimes been phrased more loosely; see, e.g., Anderson Nat'l Bank v. Luckett (1944) 321 U.S. 233, 248 ("national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions").

[31] Cf. Joy v. North (D.Conn. 1981) 519 F.Supp. 1312, 1323, reversed on other grounds (2d Cir. 1982) 692 F.2d 880, certiorari denied, Citytrust v. Joy (1983) 103 S.Ct. 1498. *Joy* rejected the argument that section 24's granting of general corporate powers preempts state corporation law: "This section [12 U.S.C. § 24] simply sets forth the general corporate powers of associations. It does not provide that the powers therein are meant to preempt state law."

"Bank Deposits and Collections" has been adopted in 49 states and is routinely applied to national banks.[32] Also, numerous provisions of the California Financial Code regulate deposit-related practices.[33] Financial Code section 100 specifically subjects national banks to its provisions insofar as those provisions do not conflict with federal law. The Comptroller's interpretation would suddenly exempt national banks from many, if not all, of these regulatory measures. There is nothing to suggest that Congress, by authorizing national banks to receive deposits, intended such a result.

The United States Supreme Court decisions construing section 24 do not support the Comptroller's expansive interpretation. Instead, whether upholding or preempting the state law, the court has focused on the narrow issue of whether the state law impeded the bank's ability to receive deposits. For example, Franklin Nat'l Bank v. New York (1954) 347 U.S. 373 held that a New York statute which prohibited all banks except nonprofit state chartered banks from using the term "savings" in their advertising, conflicted with the national bank's authorization to receive deposits.[34] Emphasizing the importance

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[32] See, e.g., Bullis v. Security Pacific Nat'l Bank, *supra*, 21 Cal.3d 801 (§ 4103); Security Pacific National Bank v. Associated Motor Sales (1980) 106 Cal.App.3d 171 (§ 4301, 4212); Fireman's Fund Insurance Co. v. Security Pacific Nat'l Bank (1978) 85 Cal.App.3d 797 (§§ 4202, 4207, 4401); Bank of America v. Security Pacific Nat. Bank (1972) 23 Cal.App.3d 638 (§ 4308).

[33] For example, chapters 7 and 8 of the Financial Code contain the following provisions affecting deposits: Section 850 (minors), section 851 (married person), section 852 (joint accounts), section 852.5 (pay-on-death provisions), section 860 (public official as officer of depository of public funds), section 863 (penalties for failure to deposit), sections 865.2 and 865.4 (disclosure of consumer bank account charges), section 874 (dormant accounts), sections 953, 954, 970, 971 (withdrawals and collections).

[34] In addition to section 24 of the National Bank Act, the court also relied on the Federal Reserve Act which provides that a na-

of advertising in competing for deposits, the court reasoned that the statute interfered with the bank's ability to receive deposits. "[W]e [cannot] construe the [National Bank Act and the Federal Reserve Act] as permitting only a passive acceptance of deposits thrust upon them. Modern competition for business finds advertising one of the most usual and useful of weapons." (*Id.*, at p. 377.)

Similarly, in another case the court found that a California law which automatically escheated dormant accounts to the state was preempted by section 24 because it impeded the bank's ability to attract deposits. (First National Bank v. California (1923) 262 U.S. 366.) But as the court later explained in Anderson Nat'l Bank v. Luckett, *supra*, 321 U.S. 233, 250, not all state escheat laws are preempted: "[The] decision [in *First Nat'l*] turned . . . on the effect of the state statute in altering the contracts of deposit in a manner considered so unusual and so harsh in its application to depositors as to deter them from placing or keeping their funds in national banks." [35] Nowhere did the court suggest that section 24 preempts all state regulation of deposit-related matters.

In an attempt to bring itself within these cases, defendant argues that *Franklin* in particular implies that

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tional bank "may continue . . . to receive time and savings deposits . . . ." (12 U.S.C. § 371.)

The purpose of the New York statute was to prevent consumer confusion between commercial banks and the state chartered institutions which pay larger returns on deposits.

[35] In *Anderson*, the court found a Kentucky law requiring transfer of abandoned, as opposed to merely dormant, accounts to the state was not preempted by section 24. "We cannot say that the protective custody of long inactive bank accounts, for which the Kentucky statute provides, and which in many circumstances may operate for the benefit and security of depositors . . . will deter them from placing their funds in national banks in that state." (*Id.*, at p. 252.)

all terms and conditions upon which national banks may compete for deposits are presumed to be the exclusive province of federal law. This reading of *Franklin* is unduly broad. *Franklin* preempted the New York law because of its deterrent effect on deposits. This holding does not logically extend into the broader proposition that every possible term or practice which may be the subject of competition between banks is beyond the reach of state law. As the numerous regulations cited earlier demonstrate, it is possible for states to regulate such "terms or conditions" without impeding banks' ability to attract deposits. And in the present setting, it is difficult to believe that persons would be deterred from depositing in federally chartered banks by the knowledge that such banks, like their state chartered counterparts, were prohibited by state law from enforcing unreasonable charges or unconscionable contracts.[36]

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[36] The bank's reliance on Fidelity Federal Savings & Loan Ass'n v. de la Cuesta (1982) 458 U.S. 141 is also misplaced. As defendant concedes, the court in that case identified an express conflict between our decision in Wellenkamp v. Bank of America (1978) 21 Cal.3d 943, which invalidated "due-on-sale" clauses as unreasonable restraints on alienation, and a Federal Home Loan Bank Board *legislative* regulation which provided that federal savings and loans have the power to include and enforce "due-on-sale" clauses in their loan instruments. (12 C.F.R. § 545.8-3(f) (1982).) Relying largely on the regulation's preamble, which stated that "due-on-sale" practices should be governed by federal law and not subject to conflicting state law, the court found the board's intent to preempt *Wellenkamp* was unambiguous and unequivocal. Thus the court's holding was clearly based upon a finding of an express conflict and an unambiguous intent to preempt state law, neither of which is present here.

Nevertheless, defendant makes the unfounded assertion that the court also held that state law is preempted, even in the absence of a direct conflict, on the strength of the federal interest in the financial well-being of federally chartered banking institutions. The court expressly noted that because it found a direct conflict, it did not reach the issue of whether Congress has occupied the entire field of federally chartered savings and loans, much less national banks.

If the National Bank Act does not displace state regulation of bank service charges, the additional enactment of the 1980 and 1982 Acts adds nothing. As we have seen, these statutes do not mention bank service charges; neither separately nor in combination with the National Bank Act can they be described as a comprehensive scheme regulating such charges. Moreover, when in the 1980 Act Congress expressly preempted state usury laws, it deliberately left in effect other provisions of state law regulating charges in contracts between banks and borrowers.[37] It is not plausible that the same Congress intended by silence to preempt all state laws regulating charges in contracts between banks and depositors.

We conclude that the Comptroller's assertion that state laws regulating service charges are preempted by a "comprehensive federal statutory scheme governing the deposit-taking function of national banks" (12 C.F.R. § 7.8000) is not a reasonable interpretation of the controlling statutes. It is not an attempt to interpret the language of the statute,[38] fill in the gaps in the statutory

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[37] The Senate committee report on the 1980 Act states that "[i]n exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers." (Sen. Rep. No. 96-368, 1st Sess., p. 19 (1979).) Thus the committee intended to leave many features of the contract between a bank and a borrower to be governed by state law, including state provisions which placed a limit on the amount the bank could charge.

[38] In determining whether a regulation represents a reasonable interpretation, the courts look initially to the plain meaning of the statutory language. (See, e.g., Addison v. Holly Hill Co. (1944) 322 U.S. 607, 617-618; Cabais v. Egger (D.C.Cir. 1982) 690 F.2d 234, 238.) In State of N.J. v. Department of Health & Human Services (3d Cir. 1981) 670 F.2d 1262 at page 1283, footnote 17, when the court upheld a regulation as a reasonable statutory inter-

coverage,[39] or to explain how the Comptroller will exercise his discretion.[40] Instead, the regulation, insofar as it claims federal preemption, represents legislation of far-reaching character and effect, of a type never considered by Congress, which would radically alter the respective roles of the states and the Comptroller in the regulation of bank-depositor contracts. Such legislation cannot be enacted in the guise of statutory interpretation.[41]

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pretation, it distinguished an earlier case, Reser v. Califano (W.D. Mo. 1979) 467 F.Supp. 446, on the ground that " '[t]he Agency in *Reser* did not purport to derive the prohibition . . . from any specific language in the Act.' "

[39] Compare Ford Motor Credit Co. v. Milhollin (1980) 444 U.S. 555, 566, upholding intersticial administrative regulations; 2 Davis, Administrative Law Treatise (2d ed. 1979) session [sic] 7.11. The decision of the Court of Appeal in Chamber of Commerce of the United States v. O.S.H.A., *supra*, 636 F.2d 464, illustrates the limits on the use of interpretative rules to fill in legislative gaps. Holding invalid a rule requiring "walkaround pay," the court said that "[t]he Administration could not be explaining or clarifying the Act's language, for . . . the Act neither prohibits nor compels pay for walkaround time. . . . Congress has not 'legislated and indicated its will' on the question of walkaround pay, therefore the Administration must have done more than exercise its 'power to fill up the details.' [¶] It is clear to us that the Administration has attempted through this regulation to supplement the Act, not simply to construe it, and therefore the regulation must be treated as a legislative rule." (P. 469.)

[40] Compare Guardian Federal S & L v. Federal S & L Ins. Corp. (D.C.Cir. 1978) 589 F.2d 658, 664; 2 Davis, *op. cit. supra*, section 7.15.

[41] During the 1960's the Comptroller issued a number of interpretative regulations which purported to interpret the provision of section 24 of the National Bank Act authorizing banks to conduct activities "convenient or useful" to the business of banking, to permit banks to engage in data processing, auto leasing, travel agent services and armored car services. The courts consistently held such regulations invalid. (See Arnold Tours, Inc. v. Camp (1st Cir. 1972) 472 F.2d 427, and cases cited p. 436, fn. 12.) We

Thus the application of state law to bank service charges is not preempted by a comprehensive federal statutory scheme which occupies the field. We therefore turn to the second preemption issue, whether the application of state law in this case will create an actual conflict with federal law in the sense that "it is impossible to comply with both state and federal law." (Silkwood v. Kerr-McGee Corp., *supra*, —— U.S. ——, —— [52 U.S. L. Week 4043, 4046].) As we have noted, no provision of federal law discusses bank service charges in general or bank charges for NSF checks in particular. Amicus California Bankers Association nevertheless points to a possibility of actual conflict. Bank directors, it observes, are required to refrain from engaging "in any unsafe or unsound practice." (12 U.S.C. § 1818 (e).) Conceivably directors might believe a charge for NSF checks low enough to avoid attack as unreasonable or unconscionable might fail to discourage the writing of NSF checks, and thus constitute an unsafe or unsound practice.

Amicus' argument proves too much, for if the mere possibility that bank directors might deem compliance with a state law to be unsound banking practice was enough to preempt the state law, the dual system of banking regulation would disappear. We recognize, of course, that in the unlikely event of actual conflict, banks must follow the federal requirements. But such actual conflict is a remote and unlikely possibility; a contractual term must be overreaching and oppressive before it is denominated "unreasonable" or "unconscionable." Surely sound banking practices would rarely, if ever, require the enforcement of oppressive contracts.[42]

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find an analogy to the present case, in which the Comptroller is also seeking to construe very general language in section 24 to achieve a specific purpose not within the contemplation of Congress.

[42] Under the Comptroller's regulation, in setting fees for services [sic] bank may consider (1) costs plus a profit margin, (2) the deterrence of misuse of banking services, (3) the enhancement of the

Finally, we come to the question whether the application of state law will stand as an obstacle to the accomplishment of the full purposes Congress sought to achieve. Defendant's argument on this matter centers on the 1980 and 1982 Acts discussed earlier in this opinion. (*Ante*, p. ——.)* As we there noted, these acts provided for gradual removal of federal regulations limiting interest paid depositors, but, apart from preempting state usury laws, did not expressly discuss the role of state regulation. Neither act mentions charges for services to depositors.

The extensive legislative history of the acts shows that Congress expected deregulation to lead banks to pay higher interest to depositors, ending the bank's ability to subsidize depositor services by paying below-market interest on deposits. Thus, Congress clearly anticipated that banks would be able to charge fees for depositor services sufficient to recover the cost of such services. Arguably a state law which required that services be offered free, or below cost, would frustrate the congressional intent by preventing the bank from paying market interest to depositors.

The state laws in question, however, permit the bank to charge fees sufficient to recover the cost of the services and a reasonable profit. We find nothing in the legislative history to suggest that Congress thought it essential that the banks be able to charge more. While an excessive charge for depositor services might help the economic status of a bank, and could enable it to subsidize interest payments and pay above-market interest, we find no indication that such is essential to the congressional purpose.

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bank's competitive position, and (4) maintenance of the safety and soundness of the bank. These same factors could be considered by a court in deciding whether a fee was unreasonable or unconscionable.

* Typed opinion at page 29.

Defendant also argues that underlying both the 1980 and 1982 Acts is the philosophy that service charges as well as interest rates should be set by market forces, not government regulations.[43] Defendant's argument mistakes the purpose of the provisions of state law at issue here. Those provisions are part of the common law governing all commercial transactions; they regulate not only sale of bank services but the sale of groceries, automobiles, furniture or medical services. The duty of good faith and fair dealing, and protection against unconscionable contracts, have never been thought incompatible with a free and competitive market. Defendant is really asking for a market free of those restraints against oppression and overreaching applicable to all other commercial operations. We find no indication that Congress envisioned not only a free and competitive market, but one freer than any other market.

In sum, the controlling doctrines of California law do not facially conflict with any federal statute or regulation. Neither does it appear from the pleading that the application of these doctrines to national bank contracts will impair the efficiency or viability of national banks, or frustrate the purpose of legislation regulating (or deregulating) those banks. Although conceivably information not contained in the pleadings might lead to a different conclusion, such information is not before us in reviewing a judgment upon demurrer. We cannot presume, without evidence, that prohibiting a national bank from setting unreasonable prices or enforcing an unconscionable contract will render that bank

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[43] Defendant consistently assumes throughout its argument that because its charges for processing NSF charges are within the range of fees charged by its competitors, its fees are the product of a free and competitive market. The conclusion does not follow from the premise. It may well be, as plaintiff charges, that banks do not compete in the setting of NSF check fees, but set fees arbitrarily, deterred only by the desirability of minimizing customer dissatisfaction.

less efficient, less competitive or less able to fulfill its function in a national banking system.[44]

VI. *Conclusion.*

Plaintiff's second and third causes of action state grounds for relief without need for further amendment; his first and fourth causes of action can be amended to state such grounds. The fifth cause of action alone is fatally defective. We conclude that the trial court erred in sustaining defendant's demurrer without leave to amend and in entering judgment for defendant.

The judgment is reversed, and the cause remanded to the superior court for further proceedings consistent with this opinion.

BROUSSARD, J.

WE CONCUR:

BIRD, C.J.
MOSK, J.
REYNOSO, J.
* WHITE, J.P.T.
* BREINER, J.P.T.
* SAVITT, J.P.T.

[Designation of counsel and trial court and appended signature card exemplar omitted]

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[44] Plaintiff's fourth cause of action charged the bank with unfair and deceptive practices. We have concluded that this cause of action is uncertain, and until the uncertainty is clarified, and the alleged unfair or deceptive practices specified, we cannot determine whether that cause of action is barred by federal law. We note, however, that although many federal statutes and regulations deal with the subject of unfair competition and deceptive practices, such statutes and regulations generally coexist peacefully with state laws regulating the same activity. (Cf. People v. Western Airlines (1984) 155 Cal.App.3d 597, cert. den. sub. nom. California v. Western Airlines (1985) —— U.S. ——.)

* Assigned by the Chairperson of the Judicial Council.

APPENDIX B

[Designation of counsel and certificate of service omitted]

SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 740-352

PAUL PERDUE, on behalf of himself and all other persons similarly situated,
Plaintiffs,

v.

CROCKER NATIONAL BANK, and DOE ONE through DOE ONE HUNDRED, inclusive,
Defendants.

[Filed February 16, 1979]

JUDGMENT OF DISMISSAL

Defendant Crocker National Bank's general demurrer to plaintiff's Complaint was considered by the Court on the briefs of the parties and without oral argument. Gary J. Near appeared as attorney for plaintiff Paul R. Perdue. Melvin F. Goldman, Charles R. Farrar, Jr., and Tony J. Tanke of Morrison & Foerster, appeared as attorneys for defendant Crocker National Bank (hereinafter "Crocker"). This Court has entered its Order sustaining without leave to amend Crocker's general demurrers to the Complaint, and each purported cause of action therein, for failure to state facts sufficient to constitute a cause of action.

Whereupon:

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED AS FOLLOWS:

1. That the Complaint, and each purported cause of action therein, are dismissed with prejudice for failure to state facts sufficient to constitute a cause of action;

2. That plaintiff is entitled to no relief in connection with any controversy alleged in the Complaint;

3. That each of plaintiff's prayers for relief is denied; and that plaintiff shall take nothing by his Complaint;

4. That Crocker shall recover from plaintiff its costs of suit.

Dated: February 15, 1979

/s/ Ira A. Brown, Jr.
IRA A. BROWN, JR.
Judge of the Superior Court

APPROVED AS TO FORM:

/s/ Gary J. Near
GARY J. NEAR
Attorney for plaintiff
Paul Perdue

APPENDIX C

[Emended to reflect April 22, 1983
order on rehearing]

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION ONE

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1 Civil No. 46808
(AO 13838)
(S.Ct.No. 740351)

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed March 25, 1983]

Appellant Paul Perdue, a depositor with respondent Crocker National Bank (Crocker), filed a purported class action below challenging the validity of charges assessed by Crocker against its depositors for processing checks drawn on commercial checking accounts without sufficient funds. Thereafter, Crocker's general demurrer

was sustained without leave to amend and a judgment of dismissal entered. This appeal ensued.

We examine the complaint before us under established principles governing review of a judgment of dismissal based upon a claimed failure to state a valid cause of action. (E.g., *Tameny v. Atlantic Richfield Co.* (1980) 27 Cal.3d 167, 170; *Alcorn v. Anbro Engineering, Inc.* (1970) 2 Cal.3d 493, 496.)

The complaint asserts five causes of action alleging in substance that Crocker's customary practice in dealing with a check drawn by a depositor on an account lacking sufficient funds ("NSF check") is either to honor and pay it as an overdraft or to dishonor and return it to the payee's banks; that in either event Crocker assesses a special handling charge ("NSF charge") against the account of its depositor-maker. It is further alleged that appellant has periodically drawn NSF checks on his Crocker checking account which Crocker—in either honoring or dishonoring such checks—has assessed a special handling charge of $6 for processing each NSF check.

I.

The gravamen of the first three causes of action for declaratory relief and unjust enrichment is that Crocker lacked any contractual or statutory authority to impose charges for NSF checks. The first cause of action seeks a declaration that the signature card signed by appellant upon opening his account, which contains an agreement that the account shall be "*subject* to all applicable laws, *to the Bank's present and future* rules, regulations, practices and *charges*" does not constitute a valid contract to serve as a basis for imposing NSF charges. (Emphasis added.) In the second cause of action, appellant seeks a declaration that the signature card constitutes an unenforceable contract of adhesion. In the third cause of action for unjust enrichment, damages are sought by

way of a refund of the difference between the charges assessed and Crocker's actual cost in processing the NSF charges.

We will conclude that neither theory survives critical analysis. [Appellant concedes the third cause of action is viable only if one of the first two causes of action is valid.]

We consider the validity of the several causes of action in a sequence convenient for discussion.

I.

The courts have long recognized that a bank signature card serves as a contract between the depositor and the bank for the handling of the account. (See *Bullis v. Security Pac. Nat. Bank* (1978) 21 Cal.3d 801, 811-812; *Blackmon v. Hale* (1970) 1 Cal.3d 548, 556; *Manti v. Gunari* (1970) 5 Cal.App.3d 442, 450-451; *Torrance N. Bk. v. Enesco F. Credit Union* (1955) 134 Cal.App.2d 316, 320-321; *Larrus v. First National Bank* (1954) 122 Cal.App.2d 884, 889-890; *Faulkner v. Bank of Italy* (1924) 69 Cal.App. 370, 374-375.) The fact that the signature card itself does not indicate the amount of Crocker's NSF charges does not negate the contractual nature of such charges, particularly where, as here, the bank's rules and regulations specifying the charges are incorporated into the signature card agreement. (*State v. San Francisco Sav. etc. Soc.* (1924) 66 Cal.App. 53, 61; *Larrus v. First Nat. Bank, supra*, 122 Cal.App.2d at pp. 889-890.) Moreover, since appellant acknowledges he had notice of the bank's scheduled charges for processing NSF checks ($6 per check), the argument advanced is patently untenable. Under the terms of the subsisting agreement, Crocker has express contractual authority to assess its scheduled service charges whenever its depositor, including appellant, presents an NSF check.

A similar contention was raised and implicitly rejected in *Hoffman v. Security Pacific Nat. Bank* (1981) 121

Cal.App.3d 964, involving a depositor's claim that the bank's imposition of service charges for processing an NSF check constituted unlawful liquidated charges on the theory that the agreement contained in the signature card to pay scheduled service charges amounted to an implied covenant by the depositor not to write overdrafts. In upholding a judgment of nonsuit, the court reasoned as follows: "Plaintiff failed to establish any such custom or any agreement on the depositors' part not to write overdrafts. Moreover, statutes governing the obligations of banks and their depositors, which are incorporated into and become part of the contract between a bank and its depositors [citations], treat an overdraft as an application for advance credit rather than as a breach of an express or implied covenant. California Uniform Commercial Code section 4401 specifically authorizes a bank to pay overdrafts and to charge customers' accounts to recover amounts paid, even when payments result in overdrafts on the account. While a bank has a statutory obligation to honor any check drawn by a depositor for an amount not exceeding the balance in his account, and *while the depositor has a contractual obligation to pay a service charge when he presents a NSF check*, the depositor has no statutory or contractual obligation to refrain from drawing checks for amounts in excess of the balance in his account. (Cal. U. Com. Code, § 4401.) In brief, plaintiff did not and could not prove that the depositors breached an obligation to Bank when they negotiated NSF checks. Accordingly, *the service charge they agreed in advance to pay for presenting such an overdraft* was not a penalty under former Civil Code section 1670." (*Id.*, p. 969; emphasis added.) (Accord *Shapiro v. United California Bank* (1982) 133 Cal.App.3d 256.)

Nor do we find merit in appellant's further argument that the signature card is an illusory contract because it permits the bank unilaterally to fix the NSF charges

and to make future changes at will. It is well established that an agreement which reserves the power to one party to vary a term is not thereby rendered illusory or otherwise void for lack of mutuality. (See *Vanguard Investments v. Central Cal. Fed. Sav. & Loan Assn.* (1977) 68 Cal.App.3d 950, 958; *Powell v. Central Cal. Fed. Sav. & Loan Assn.* (1976) 59 Cal.App.3d 540, 549 [loan agreement permitting lender to increase rate of interest]; *Automatic Vending Co. v. Wisdom* (1960) 182 Cal.App.2d 354, 358 [agreement permitting vendor to change commission rate]; *Inderkum v. German Old People's Home* (1937) 23 Cal. App.2d 733, 735 [life care contract subject to future amendments of by-laws].) However, the exercise of the power to effect changes must be reasonable. Thus, for example, in *Inderkum* the court held that the future by-law amendments must be "reasonable administrative amendments" and not changes impairing the substance of the contract. (23 Cal.App.2d at p. 738.) In *Automatic Vending*, the court held the new price must be fixed "in such amount as the object of the contract is reasonably worth." (182 Cal.App.2d at p. 358.) And in *Powell v. Central Cal. Fed. Sav. & Loan Assn.*, *supra*, the court found the lender's one percent increase in the interest rate was reasonable when compared with the interest increases for depositors. (59 Cal.App.3d at pp. 549-550.)[1]

Appellant advances an alternative argument that the signature card constitutes an unenforceable contract of adhesion because depositors receive inadequate notice that execution of the signature card subjects them to NSF charges and by reason of the great disparity between the NSF charge and the bank's actual cost of

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[1] We emphasize that no question is raised in this case regarding Crocker's exercise of its power to *change* the NSF charges. Accordingly, we express no opinion as to the permissible latitude in increasing such charges unilaterally.

processing NSF checks. We disagree on the record before us.

Conceptually, a contract of adhesion generally "'. . . signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817; *Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694.) Although arguably the signature card may reasonably be interpreted as a contract of adhesion between the bank and its depositor, such determination does not end the inquiry. "There is nothing sinful or illegal about a contract of adhesion; the only significant result of the existence of such a contract is that it is interpreted against the supplier of the goods or services (who prepared it) so as to meet the reasonable expectations of the customer." (*Powell v. Central Cal. Fed. Sav. & Loan Assn., supra*, 59 Cal.App.3d 540, 551.)

As *Scissor-Tail* instructs, the provisions of an adhesion contract are fully enforceable in the absence of two judicially imposed constraints: "The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. (See, e.g., *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 271-272 [54 Cal.Rptr. 104, 419 P.2d 168]; *Steven v. Fidelity & Casualty Co.* (1962) 58 Cal.2d 862, 869-870 [27 Cal. Rptr. 172, 377 P.2d 284]; *Wheeler v. St. Joseph Hospital, supra*, 63 Cal.App.3d 345, 357; see generally *Sybert, supra*, at pp. 305-306, and cases there cited.) The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' (See, e.g., *Steven, supra*, 58 Cal.2d at pp. 878-879; *Jacklich v. Baer*

(1943) 57 Cal.App.2d 684 [135 P.2d 179].)" (Fns. omitted.) (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal. 3d at p. 820; see also *Holmes v. City of Los Angeles* (1981) 117 Cal.App.3d 212, 216-217, app. dis. 454 U.S. 884.) Although in *Scissor-Tail* the court determined that the contract between a sophisticated promoter and a music performer was a contract of adhesion, the court further concluded that the contractual provision requiring arbitration of disputes was in nowise contrary to the promoter's expectations, particularly since he had been a party to literally thousands of contracts containing similar arbitration provisions and was undoubtedly aware of the arbitration requirement. (*Graham v. Scissor-Tail, Inc., supra*, at p. 821.)

In congruent analysis, we find nothing ambiguous or unexpected about the specific NSF charges imposed by Crocker. The signature card agreement plainly states that the depositor will pay the bank's scheduled processing charges. As noted, appellant acknowledges he was aware of the NSF charges before he wrote the NSF checks. Under such uncontroverted circumstances, we conclude that the signature card in no way conflicts with appellant's reasonable expectations.

Appellant's next argument, to which the parties and amici devote considerable discussion in their briefs, focuses on the second factor underscored in *Scissor-Tail* limiting enforcement of adhesion contracts: namely, whether the contract or provision is unduly oppressive or unconscionable. Appellant contends that the disparity between the bank's actual *costs* of processing NSF checks (alleged to be 30¢ per check) and the *charges* imposed ($6 per check) is so excessive as to render the contract unconscionable and unenforceable. Again we are unable to agree.

In the recent decision of *A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, the appellate court

thoroughly examined the flexible concept of unconscionability in the context of the enforceability of a warranty disclaimer and damages exclusion clause contained in a commercial contract. We can add little to that enlightening exegisis by Justice Wiener which we adopt in pertinent part herein: "Phrased another way, unconscionability has both a 'procedural' and a 'substantive' element. (*Industralease Automated & Scientific Eq. Corp., etc.* (1977) 58 App.Div.2d 482 [396 N.Y.S.2d 427, 431, fn. 4]; see also Leff, *supra*, 115 U.Pa.L.Rev. at p. 487; White and Summers, *supra*, § 4-3 at p. 151.)

"The procedural element focuses on two factors: 'oppression' and 'surprise.' (See U. Com. Code com. No. 1, 23A West's Ann. Cal. U. Com. Code (1964 ed.) § 2302, p. 198; *Geldermann and Company, Inc. v. Lane Processing, Inc.* (8th Cir. 1975) 527 F.2d 571, 575.) 'Oppression' arises from an inequality of bargaining power which results in no real negotiation and 'an absence of meaningful choice.' (*Williams v. Walker-Thomas Furniture Company*, supra, 350 F.2d at p. 449; *Fleischmann Distilling Corp. v. Distillers Co. Ltd.* (S.D.N.Y. 1975) 395 F.Supp. 221, 232; see Spanogle, *Analyzing Unconscionability Problems* (1969) 117 U.Pa.L.Rev. 931, 944-946.) 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms. (See Ellinghaus, *In Defense of Unconscionability* (1969) 78 Yale L.J. 757, 764-765; Eddy, *On the 'Essential' Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)* (1977) 65 Cal.L.Rev. 28, 43; Spanogle, *supra*, 117 U.Pa. L.Rev. at pp. 934-935, 943.) Characteristically, the form contract is drafted by the party with the superior bargaining position. (See Calamari and Perillo, Contracts (2d ed. 1977) § 9-40, p. 325.)

"Of course the mere fact that a contract term is not read or understood by the nondrafting party or that the

drafting party occupies a superior bargaining position will not authorize a court to refuse to enforce the contract . . . [since] commercial practicalities dictate that unbargained-for terms only be denied enforcement where they are also *substantively* unreasonable. (Ellinghaus, *supra*, 78 Yale L.J. at pp. 766-767; Murray on Contracts, *supra*, at pp. 748-749.) No precise definition of substantive unconscionability can be proffered. Cases have talked in terms of 'overlyharsh' or 'one-sided' results. (See, e.g., *Schroeder v. Fageol Motors, Inc.* (1975) 86 Wn.2d 256 [544 P.2d 20, 23]; *Weaver v. American Oil Company* (1972) 257 Ind. 458 [276 N.E.2d 144, 146, 49 A.L.R.3d 306].) One commentator has pointed out, however, that '. . . unconscionability turns not only on a "one-sided" result, but also on an absence of "justification" for it' (Eddy, *supra*, 65 Cal.L.Rev. at p. 45), which is only to say that substantive unconscionability must be evaluated as of the time the contract was made. (See U. Com. Code, § 2-302.) The most detailed and specific commentaries observe that a contract is largely an allocation of risks between the parties, and therefore that a contractual term is substantively suspect if it reallocates the risks of the bargain in an objectively unreasonable or unexpected manner. (Murray, *Unconscionability: Unconscionability* (1969) 31 U.Pitt.L.Rev. 1, 12-23; see also Eddy, *supra*, 65 Cal.L.Rev. at pp. 45-51; *Geldermann and Company, Inc. v. Lane Processing, Inc.*, *supra*, 527 F.2d at p. 576.) But not all unreasonable risk reallocations are unconscionable; rather, enforceability of the clause is tied to the procedural aspects of unconscionability (see *ante*, pp. 485-476 [sic]) such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk reallocation which will be tolerated. (See Spanogle, *supra*, 117 U.Pa. L.Rev. at pp. 950, 968.)" (*Id.*, at pp. 486-487.)

In this case, although the procedural aspects of unconscionability arguably are manifest, we find nothing

commercially or objectively unreasonable in the NSF charges actually imposed. The extent of the service charge imposed for the bank's handling of an NSF check was neither hidden nor unexpected, *but instead was concededly known to appellant before he wrote NSF checks.* Appellant could have easily avoided the NSF charge by simply refraining from writing checks on an account with insufficient funds. Under governing principles and in light of the total circumstances reflected in this record, we determine as a matter of law that the alleged disparity between the cost of processing and the charges actually imposed do not rise to the level of substantive unconscionability so as to deny enforcement of the service charge agreement.[2]

In conclusion, we hold that Crocker possessed a valid and enforceable contractual right to impose the particular NSF service charges alleged. Accordingly, the demurrer was properly sustained as to the first three causes of action.

II.

Appellant's fourth cause of action alleges unfair and deceptive business practices by Crocker in that depositors were not apprised that the signature card subjected them to NSF charges, and were led to believe the card was only a handwriting exemplar.[3] But the complaint fails to allege any ultimate facts indicating in what

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[2] We are not unmindful of the compelling policy arguments advanced by amici in support of appellant. Our decision is, of course, limited to the record before us and is itself subject to review. But the question of potential abuse in the form of expansive or indiscriminate charges is *not* before us; any corrective measures necessary to prevent such likelihood should be directed to the Legislature and not the courts.

[3] Unfair competition, proscribed by sections 17200-17208 of the Business and Professions Code, is defined to include an "unlawful, unfair or fraudulent business practice. . . ." (Bus. & Prof. Code, § 17200).

manner depositors were misled or deceived. As repetitively shown, the signature card explicitly recites the depositor's agreement to pay service charges, a fact openly acknowledged by appellant. Such facial inadequacy was vulnerable to a general demurrer; the order sustaining Crocker's demurrer thereto was clearly proper.

III.

In his fifth cause of action,[4] appellant complains that the NSF charges constitute unenforceable liquidated damages under the provisions of former Civil Code section 1670 (repealed by Stats. 1977, ch. 198, § 2, operative July 1, 1978; see now Civ. Code § 1671, as amended). The specific complaint is likewise unfounded.

As earlier noted, identical arguments were urged unsuccessfully in *Shapiro v. United California Bank*, *supra*, 133 Cal.App.3d 256, and *Hoffman v. Security Pacific Nat. Bank*, *supra*, 121 Cal.App.3d 964. We subscribe to the reasoning in those decisions that the standardized signature card did not include an implied promise by the depositor to refrain from writing NSF checks which would support a conclusion that the provision amounted to an unenforceable penalty. Rather, an NSF check is deemed to be an application for advance credit. Consequently, the issuance of an NSF check does not constitute a breach of contract and the provisions of former Civil Code section 1670 do not apply.

The judgment is affirmed.

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[4] The general demurrer to this count was sustained pursuant to stipulation.

CERTIFIED FOR PUBLICATION.

RACANELLI, P. J.

WE CONCUR:

ELKINGTON, J.

NEWSOM, J.

[Designation of counsel and trial court omitted]

APPENDIX D

[Designation of counsel omitted]

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 740352

PAUL PERDUE, on behalf of himself and all others similarly situated,
Plaintiffs,

vs.

CROCKER NATIONAL BANK, and DOE 1 THROUGH DOE 100, INCLUSIVE,
Defendants.

[Filed July 3, 1978]

CLASS ACTION COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF AND DAMAGES

Plaintiff alleges:

FIRST CAUSE OF ACTION

DECLARATORY AND INJUNCTIVE RELIEF UPON THE GROUNDS THAT THE SIGNATURE CARD IS NOT A CONTRACT

1.

Plaintiff brings this action on behalf of all persons similarly situated pursuant to CAL. CODE CIV. PROC § 382, on the following grounds:

A. Each class member has a checking account with defendant and seeks declaratory and injunctive relief in addition to damages for charges imposed by defendant because of processing checks presented against insufficient funds. This class also includes a subclass which exists of persons who had accounts and paid the charge within the applicable period of limitations.

This class and subclass consist of individual members so numerous that joinder or other alternative proceedings are impractical. The names and addresses of class members are presently unknown to plaintiff, but can be readily ascertained from the defendant's business records. [Hereafter "plaintiff(s)" shall refer to the named plaintiff(s) as well as members of the class.]

B. The common or similar issues of law and fact which predominate over individual issues include, but are not limited to, the following:

1. Each member of the class has or had a checking account with defendant and the account has been charged for the processing of checks presented against insufficient funds.

2. The legal rights and obligations of the parties are identical concerning the imposition of the amount charged by defendant for processing checks presented against insufficient funds on plaintiffs' accounts.

3. Proof of common facts and legal doctrines by the representative plaintiff will determine the claims of each member of plaintiffs' class.

4. The class action proceeding will provide a practical basis for the determination of all interests of the parties, prevent inconsistent adjudications, maximize judicial economy, and is superior to all other available methods of fair and efficient adjudication of the controversy.

C. The named representative's claims are typical and representative of the class and subclass claims because

(s)he has a checking account and has paid the special handling charge.

D. The named representative will fairly and adequately represent and protect the class interests because her/his interests are neither adverse nor inconsistent with the class interest.

2.

Defendant CROCKER NATIONAL BANK is a banking association, doing business and maintaining branch offices in San Francisco.

3.

The true names, identies [sic] and legal capacities of the defendants sued herein as DOE 1 through DOE 100 are unknown to plaintiffs and therefore said defendants are sued by fictitious names under the provisions of CAL. CODE CIV. PROC. § 474. Each of said DOE defendants was an agent, principal, employer, employee, subsidiary, partner, associate, joint venturer or person exercising control of another defendant liable for the wrongful acts alleged herein. Each of said DOE defendants is legally responsible in some manner for the wrongful acts, injury and damages alleged herein.

4.

Banking transactions are subjected to closer scrutiny than ordinary commercial transactions by various regulatory bodies and the courts and defendants owe a duty of fair dealing toward plaintiffs.

5.

The possession and use of a checking account is a practical necessity for the plaintiffs.

6.

Defendants offer to the plaintiffs and the general public checking services. Defendants receive deposits of money

on behalf of the plaintiffs and, upon presentation of a check drawn by plaintiffs, disperse money as directed by the check.

7.

Defendants offer said checking services in exchange for a promise by plaintiffs to pay a predetermined charge set by defendants [hereafter called the "maintenance charge."] Plaintiffs, at the commencement of the checking account agreed to pay said maintenance charge, or to maintain a minimum balance in their checking account or some similar arrangement, unless such charge was waived. This maintenance charge is stated on periodic statements issued to the respective plaintiffs by the defendant.

8.

It is the practice of defendants to impose and collect a unilaterally set charge for processing checks presented against plaintiffs' accounts when such accounts do not contain sufficient funds to cover the amount of the check [hereafter called "NSF checks"]. This charge, imposed separately from and in addition to a maintenance charge for other regular checking activity, is hereafter referred to as the "NSF charge."

9.

Defendants, in fact, can and do off-set the amount of the NSF charge against any remaining balance in the account and do not have to bring suit or take any other affirmative action to collect the charge against plaintiffs' accounts.

10.

Defendants have at various times unilaterally increased the NSF charge to an amount the defendants deemed appropriate, without reference to any criteria, and defendants imposed and collected the said increased amount without any explanation or justification by defendants to plaintiffs.

11.

Defendants require of each plaintiff a signature upon an individual card. Attached as Exhibit 1 and incorporated by reference as though set forth in full is a copy of such card used by the defendants and called a signature card.

12.

The signature card is retained by the defendants and plaintiffs are not provided with a copy of the card.

13.

The defendants use the signature card to determine and verify the authenticity of endorsements on checks. For that purpose, the defendants require plaintiffs to submit an exemplar of their signatures on the signature card.

14.

The signature card prepared by the defendants does not identify the amount of any charge to be paid by the plaintiffs for processing NSF checks and is not an agreement for such payment. The card does not constitute mutual assent to NSF charges in any particular sum or at all and accordingly is not a contract conferring authority to do the acts complained of herein.

15.

Based upon the language of the signature card, the plaintiffs believed and expected that the signature card was intended as a handwriting exemplar for purposes of identification and verification only.

16.

In the course of checking account activity by the plaintiffs, certain checks of plaintiffs have been and will be presented which exceed the amount then on deposit in their respective accounts.

17.

Defendants anticipate that plaintiffs will cause checks to be presented against insufficient funds in their accounts and defendants impose a charge for each NSF check presented whether returned or honored. Said charge is $6.00. Attached as Exhibit 2 is a true copy of a notice of said charge to the named plaintiff.

18.

Plaintiffs allege, upon information and belief, that the actual cost incurred by the defendants in processing an NSF check is approximately $0.30, which cost was at all times known to the defendants.

19.

Plaintiffs have performed all conditions required of them, except as performance is excused or waived, relating to the checking account with the defendants.

20.

A present and actual controversy exists between the plaintiffs and the defendants concerning their respective rights and obligations. A controversy exists as to whether the signature card is a valid or enforceable contract and whether said signature card is a lawful basis for the imposition of the NSF charge. Plaintiffs contend that the signature card is not a contract and that the endorsement of the signature card by the plaintiffs—given its language, form and appearance—does not create a legal and binding contract for the defendants' authority to impose the NSF charge. Defendants contend that the signature card is a valid and enforceable contract and that it provides the lawful authority to impose and collect the NSF charge.

21.

Plaintiffs desire a judicial determination of the nature, scope, force and effect of the relationship created by the

signature card. Declaratory relief is both necessary and appropriate to resolve this question. Unless enjoined, defendants will continue to do the acts complained of and declared to be improper.

SECOND CAUSE OF ACTION:

DECLARATORY AND INJUNCTIVE RELIEF BASED UPON THE GROUNDS THAT THE SIGNATURE CARD IS ILLUSORY, AMBIGUOUS AND AN OPPRESSIVE CONTRACT OF ADHESION

22.

Plaintiffs hereby incorporate Paragraphs 1 through 13 and Paragraphs 15 through 19 as though fully set forth herein.

23.

The signature card used by defendants to conduct their part of the checking account relationship is prepared and drafted and imposed by defendants in a standard form.

24.

A disparity in bargaining power exists between plaintiffs and the defendants in favor of the defendants. The relative economic power, knowledge, experience, resources and expertise of the defendants in the checking account relationship relegates the plaintiffs to an inferior bargaining position at all stages of such relationship.

25.

Plaintiffs must acquiesce in the checking account relationship exactly as it is offered by the defendants. Plaintiffs are further forced to accept a similar arrangement with other banks, or to forego checking services.

26.

The language of the signature card is illusory in that, among other things, it fails to commit the defendants to

any obligation, duty or responsibility. The language of the signature card reserves the right to defendants to alter, at any time, any aspect of the checking account relationship, including the absolute right by defendants to terminate the account without prior notice and to set or alter the amount at any level of any charges including the NSF charge. The defendants have unilaterally increased the amount of the NSF charge from time to time, and have terminated accounts of plaintiffs without prior notice to such plaintiffs.

27.

The signature card is drafted by defendants in a manner not adequate to create any enforceable contract right to impose or collect the NSF charge.

28.

The signature card is ambiguous, vague and uncertain as to whether it is an identification card or, as defendants contend, a valid and enforceable contract to impose and collect the NSF charge.

29.

The conduct and practice of defendants occasionally to advance monies to the plaintiffs by honoring NSF checks, in the sole discretion of the defendants, has resulted in ambiguity, confusion and uncertainty as to the rights and obligations of the plaintiffs in handling of their checking accounts and as to the meaning of the signature card.

30.

The disparity between the actual cost to defendants and the amount charged by defendants for processing an NSF check unreasonably and oppressively imposes excessive and unfair liability upon plaintiffs.

31.

A present and actual controversy exists between the plaintiffs and the defendants concerning their respective

rights and duties as to whether: (A) Any obligation of plaintiffs to pay NSF charges pursuant to any language of the signature card is unenforceable because defendants claim the power to and do alter or terminate the arrangement at will; (B) Plaintiffs are not obligated to pay the NSF charge pursuant to the signature card because it is adhesive and does not unambiguously provide therefor; (C) Defendants lack lawful authority pursuant to the signature card to impose the NSF charge because the NSF charge is an oppressive and unreasonable imposition of liability upon plaintiffs which does not reflect the actual cost to defendants for processing the NSF check. Defendants assert that the NSF charge is authorized by the signature card; plaintiffs contend that the signature card confers no such authority.

32.

Plaintiffs desire a judicial determination of their rights and duties and a declaration as to whether or not the NSF charge is authorized and enforceable by virtue of the signature card. A judicial declaration is necessary and appropriate so that plaintiffs may ascertain their rights and duties. Unless enjoined, defendants will continue to do the acts complained of and declared to be improper.

THIRD CAUSE OF ACTION

UNJUST ENRICHMENT

Plaintiffs hereby incorporate Paragraphs 1 through 10, 16 through 19, 23 through 25, and 30 as though fully set forth herein.

33.

If plaintiffs prevail on either the First or Second Cause of Action, then the defendants' imposition of the NSF charge on plaintiffs' checking accounts has resulted in the payment of substantial sums of money to defendants, which amounts properly belong to plaintiffs, and which

amounts constitute an unjust enrichment to the defendants to the extent said sums exceed the actual processing costs of NSF checks.

34.

Defendants continue to retain said funds.

35.

Plaintiffs have been damaged by reason of defendants' imposition and retention of the NSF charges in an amount not known to plaintiffs but known to defendants.

36.

Plaintiffs request that the amounts retained by defendants that constitute an unjust enrichment be returned as damages to the plaintiffs.

FOURTH CAUSE OF ACTION

UNFAIR, DECEPTIVE AND MISLEADING BUSINESS PRACTICES

37.

Plaintiffs hereby incorporate Paragraphs 1 through 18 and Paragraphs 23 through 30 as though fully set forth herein.

38.

Said signature card is used in a manner which is unfair, deceptive and misleading, in that plaintiffs are led to believe that it is a signature card for identification purposes and the defendants treat the signature card, without disclosure of said fact, as the legal authority to impose the NSF charge on plaintiffs' checking accounts.

39.

From time to time, defendants arbitrarily and capriciously waive the NSF charge for preferred or commercial accounts. Said waiver is a further unfair business prac-

tice because it forces plaintiffs, who have had their accounts charged, to shoulder the cost that the defendants incur for processing NSF checks of others at the expense of plaintiffs to the benefit of the preferred customers.

40.

Defendants' practices are likely to deceive and have deceived plaintiffs and other members of the public in violation of CAL. BUS. & PROF. CODE §§ 17200 *et seq.* Unless enjoined, said conduct will continue.

FIFTH CAUSE OF ACTION

CIVIL CODE § 1670

41.

Plaintiffs hereby incorporate Paragraphs 1 through 9, 11, 13, 16, 17, 18, 23, 24, 25 and 30 as though fully set forth herein.

42.

Causing NSF checks to be presented for payment is a breach by plaintiffs of their contractual obligations to defendants to refrain from causing NSF checks to be presented for payment or to maintain a positive account balance.

43.

Defendants' imposition of the NSF charge is a penalty and is not imposed to compensate defendants for damages incurred by plaintiffs' breach by causing the presentation of NSF checks and is therefore an unlawful charge.

44.

The imposition of said charge by defendants is a violation of and is contrary to the express provisions of CAL. CIV. CODE § 1670 and is not exempted therefrom by CAL. CIV. CODE § 1671.

45.

From actual experience and knowledge, defendants can determine the actual pro rata cost of NSF checks. On information and belief, said cost is approximately thirty ($0.30) cents.

46.

Plaintiffs are entitled to recover the difference between the unlawful charges collected and defendants' actual damages sustained.

PRAYER

Plaintiffs request the following relief:

1. Declaratory relief whether the signature card is a valid and enforceable contract and

(a) if so, what the rights and obligations of the parties are thereunder and for an injunction against any conduct complained of herein not authorized thereunder;

(b) if not, for an injunction against any claim or use by defendants thereof as the authority for imposing NSF charges;

2. An accounting of all NSF charges and for a determination as to how much thereof must be refunded to plaintiffs;

3. An injunction against all unfair business practices found to exist;

4. Reformation of the signature card in accordance with the declaratory and injunctive relief granted;

5. An order enjoining the defendants from imposing an NSF charge in excess of defendants' actual costs of processing an NSF check;

6. An order requiring defendants to advertise to and advise the public and plaintiffs of their rights and obliga-

tions concerning the checking account practices of the defendants;

7. Reasonable attorneys' fees and costs of suit; and

8. Such other relief as is just and proper.

DATED: June 27, 1978.

GARY J. NEAR
KIPPERMAN, SHAWN, KEKER & BROCKETT

By _____
STEVEN M. KIPPERMAN
Counsel for Plaintiffs.

[Exhibit 1 and Exhibit 2 have been omitted. Exhibit 1 is a notice of advice of charges for special services—checking account. Exhibit 2 is an exemplar of appellant's deposit account signature card contract.]

APPENDIX E

ORDER DUE
August 16, 1985

ORDER DENYING REHEARING
IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

SF No. 24591

PERDUE,

Appellant

v.

CROCKER NATIONAL BANK,

Respondent

KAUS, J. AND GRODIN, J., DID NOT PARTICIPATE.

[Filed Aug. 15, 1985]

IN BANK

Respondent's petition for rehearing DENIED.

/s/ Bird
Chief Justice

APPENDIX F

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

SF No. 24591

1 Civil No. A013838
Superior Court No. 740352

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed September 5, 1985]

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that CROCKER NATIONAL BANK, the defendant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California entered herein on July 18, 1985, sustaining the validity of state statutes, including California Civil Code § 1670.5, against the claim that they are repugnant to the Constitution, treaties or laws of the United States.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: September 5, 1985.

/s/ William Alsup
WILLIAM ALSUP
MORRISON & FOERSTER
One Market Plaza
Spear Street Tower
San Francisco, CA 94105
Telephone: (415) 777-6000

Attorneys for
Defendant-Respondent
CROCKER NATIONAL BANK

[Affidavit of service by mail and service list deleted]

APPENDIX G

12 U.S.C. § 24

Corporate powers of associations

Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * * *

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits . . . .

* * * *

12 U.S.C. § 484

Limitation on visitorial powers

(a) No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

(b) Notwithstanding subsection (a) of this section, lawfully authorized State auditors and examiners may, at reasonable times and upon reasonable notice to a bank, review its records solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws.

APPENDIX H

12 U.S.C. § 3501

Congressional findings and declaration of purpose

(a) The Congress hereby finds that—

(1) limitations on the interest rates which are payable on deposits and accounts discourage persons from saving money, create inequities for depositors, impede the ability of depository institutions to compete for funds, and have not achieved their purpose of providing an even flow of funds for home mortgage lending; and

(2) all depositors, and particularly those with modest savings, are entitled to receive a market rate of return on their savings as soon as it is economically feasible for depository institutions to pay such rate.

(b) It is the purpose of this subchapter to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts by depository institutions by extending the authority to impose such limitations for 6 years, subject to specific standards designed to ensure a phase-out of such limitations to market rates of interest.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 202, 94 Stat. 132, 142]

12 U.S.C. § 3502

Depository Institutions Deregulation Committee

(a) Transfer of statutory authorities

The authorities conferred by sections 371b, 1425b (a), and 1828(g) of this title or by any other

provision of Federal law, other than section 1763 of this title, to prescribe rules governing the payment of interest and dividends and the establishment of classes of deposits or accounts, including limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts, and the authority conferred by the provisions of section 102 of Public Law 94-200 (12 U.S.C. 461 note) are hereby transferred to the Depository Institutions Deregulation Committee (hereinafter in this subchapter referred to as the "Deregulation Committee").

(b) Membership; meetings; voting

The Deregulation Committee shall consist of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the National Credit Union Administration Board, who shall be voting members, and the Comptroller of the Currency who shall be a nonvoting member of the Deregulation Committee. The Deregulation Committee shall hold public meetings at least quarterly. All meetings of the Deregulation Committee shall be conducted in conformity with the provisions of section 52b of title 5. The Deregulation Committee may not take any action unless such action is approved by a majority vote of the voting members of the Deregulation Committee.

(c) Delegation of authorities prohibited

The authorities conferred by this subchapter on the Deregulation Committee and its members may not be delegated.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 203, 94 Stat. 132, 142]

12 U.S.C. § 3503

Phase-out and elimination of limitations, and gradual increases of maximum rates of interest and dividends paid on deposits and accounts

(a) Exercise of authorities; methods employed

The Deregulation Committee shall, by regulation, exercise the authorities transferred by section 3502 of this title to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts as rapidly as economic conditions warrant. The phase-out of such limitations may be achieved by the Deregulation Committee by the gradual increase in such limitations applicable to all existing categories of accounts, the complete elimination of the limitations applicable to particular categories of accounts, the creation of new categories of accounts not subject to limitations or with limitations set at current market rates, any combination of the above methods, or any other method.

(b) Maximum amounts of increases

The Deregulation Committee shall work toward providing all depositors with a market rate of return on their savings with due regard for the safety and soundness of depository institutions. Pursuant to the authority granted by this subchapter, the Deregulation Committee shall increase all limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts to market rates as soon as feasible, except that the Deregulation Committee shall not increase such limitations above market rates during the six-year period beginning on March 31, 1980.

(c)(1) Money market deposit accounts; authorization; competitiveness with money market mutual funds; limitations on maximum rate of interest barred; transaction account reserves requirement inapplicable

The Committee shall issue a regulation authorizing a new deposit account, effective not later than 60 days after October 15, 1982. Such account shall be directly equivalent to and competitive with money market mutual funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 [15 U.S.C. § 80a-1 et seq.].

(2) No limitation on the maximum rate or rates of interest payable on deposit accounts shall apply to the account authorized by this subsection.

(3) For purposes of section 461(b) of this title, accounts established pursuant to this subsection which are not "transaction accounts" as defined by the reserve requirement regulations of the Board of Governors of the Federal Reserve System as those regulations existed on August 1, 1982, shall not be subject to transaction account reserves, even though no minimum maturity is required, and even though up to three preauthorized or automatic transfers and three transfers to third parties are permitted monthly.

(4) The transitional adjustment provisions in section 461(b)(8) of this title, providing for the phase-in of reserve requirements, shall not apply to an account established pursuant to this subsection.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 204, 94 Stat. 132, 143; Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Title III, § 327, 96 Stat. 1469, 1501]

12 U.S.C. § 3504

Voting requirements respecting targets for limitations on maximum rates of interest and dividends paid on deposits and accounts and phase-out of interest rate controls; adjustment of limitations

(a) In order to assist the Deregulation Committee in establishing the limitations on the maximum rates of interest and dividends which may be paid on all deposits and accounts at market rates as soon as feasible and in order to provide maximum assurance that interest rate controls will be phased-out during the 6-year period following March 31, 1980, the Deregulation Committee shall vote, not later than 18 months after March 31, 1980, on whether to increase the limitations on the maximum rates applicable to passbook and similar savings accounts by at least one-fourth of one percentage point during such 18-month period, and shall vote, not later than the end of the third, fourth, fifth, and sixth years after March 31, 1980, on whether to increase the limitations on the maximum rates applicable to all categories of deposits and accounts by at least one-half of one percentage point.

(b) The Deregulation Committee may, consistent with the purposes of this subchapter, adjust the limitations on the rates applicable to all categories of deposits and accounts to rates which are higher or lower than the targets set forth in this section.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 205, 94 Stat. 132, 143]

12 U.S.C. § 3505

Reporting requirements for individual members of Deregulation Committee; contents

Each member of the Deregulation Committee shall separately report to the Congress annually after

March 31, 1980 regarding the economic viability of depository institutions. Each such report shall contain—

(1) an assessment of whether the removal of any differential between the rates payable on deposits and accounts by banks and those payable by thrift institutions will adversely affect the housing finance market or the viability of the thrift industry;

(2) recommendations for measures which would encourage savings, provide for the equitable treatment of small savers, and ensure a steady and adequate flow of funds to thrift institutions and the housing market;

(3) findings concerning disintermediation of savings deposits from insured banks and insured thrift institutions to uninsured money market innovators paying market rates to savers; and

(4) recommendations for such legislative and administrative actions as the member involved considers necessary to maintain the economic viability of depository institutions.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 206, 94 Stat. 132, 143-44]

12 U.S.C. § 1832

Withdrawals by negotiable or transferable instruments for transfers to third parties

(a) Authority of depository institution; applicability

(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable

instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit, and with respect to deposits of public funds by an officer, employee, or agent of the United States, any State, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

* * * *

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title III, § 303, 94 Stat. 132, 146]

APPENDIX I

48 Fed. Reg. 54319 (1983)

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 7

[Docket No. 83-53]

Interpretive Ruling Concerning
National Bank Service Charges

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: This interpretive final rule clarifies the position of the Office regarding the ability of national banks to levy charges relating to services performed for customers in connection with deposit accounts. This action is necessary to incorporate into the service charge ruling interpretations which have been rendered under that ruling and to clarify that state law which interferes with the ability of national banks to establish service charges is preempted. The intended effect of this action is to provide certainty to banks and customers alike regarding, respectively, their ability to impose, or liability for, service charges by national banks in connection with deposit accounts.

EFFECTIVE DATE: December 2, 1983.

FOR FURTHER INFORMATION CONTACT: Jerome Edelstein, Attorney, Legal Advisory Services Division, [202] 447-1880, Office of the Comptroller of the Currency, Washington, D.C. 20219.

SUPPLEMENTARY INFORMATION:

Background

The Office is updating its interpretive ruling, 12 CFR 7.8000, regarding the imposition of service charges by national banks. This action is taken in response to disputes, including litigation, which have arisen over deposit account service charges by national banks. Clarification is particularly important at this time in light of current competitive conditions and the lifting of interest ceilings on certain deposit accounts. These changes underscore the need for banks to have flexibility to develop pricing policies to serve their corporate and competitive needs. Thus, the Office is codifying and clarifying certain principles relevant to the imposition of service charges by national banks. It is expected that this codification will provide needed certainty in this area.

Discussion

The ruling adds the following provisions to the current interpretive ruling. First, the final rule restates the longstanding Office position that the establishment of deposit account service charges and the amounts thereof are business decisions properly made by bank management for which the Office does not substitute its judgment. Second, the ruling makes it clear that in setting deposit account service charges, national banks may consider, but are not limited to considering:

—Recovering costs incurred by the bank in providing the service, plus a profit margin. Absent the ability to recover such costs and receive a profit, banks may be unwilling to provide a given service, thus limiting competition and customer choices.

—Deterring of misuse by borrowers. Certain deposit account services provided by banks, such as the honoring of checks drawn against nonsufficient funds, have

the potential for misuse. It has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances. Such a practice, if left uncontrolled, provides a customer with automatic loans. Alternatively, the bank could automatically dishonor all checks drawn on nonsufficient funds. A bank, however, may hesitate to do this because of the embarrassment to its customer. An appropriate option, the Office believes, is to establish service charges to be levied in connection with the writing of nonsufficient fund checks by borrowers to discourage customers from frequently writing such checks.

—Enhancing of the competitive position and the marketing strategy of the bank. It is the position of the Office that banks should have the ability to set service charges to encourage or discourage the use of certain services in line with the bank's goals and corporate requirements.

—Maintaining of safety and soundness. Service charges should always be established with consideration of their impact on the financial health and profitability of the bank.

Third, the ruling clarifies that in accordance with general principle [sic] of federal preemption of state law, the amounts of deposit account service charges may not be limited, restricted or prohibited by state law. State law that tends to impair the efficiency of national banks or conflicts with the paramount laws of the United States is preempted. State laws which limit, restrict, or prohibit the amounts of deposit account service charges by national banks impair the ability of national banks to exercise their authority to take deposits under 12 U.S.C. 24 Seventh. Also, deregulation, including the lifting of interest rate ceilings on numerous types of accounts, underscores the need for national banks to have flexibility in the establishment of deposit account service

charges so that they may continue to pay depositors market rates of interest. Further, the safety and soundness of banks depends in significant part on their ability to devise price structures appropriate for their needs. Any state law impediments to national bank flexibility have potentially serious implications for their continued safety and soundness. In such circumstances, the authority to regulate has been given by Congress to this Office as part of its mission of monitoring the safety and soundness of the national banking system. Attempts by states to regulate in the area are preempted as being in conflict with the statutory scheme under which the national banking system is regulated.

Title 12 CFR 7.8000 is not applicable to service charges imposed by a national bank in its capacity as a fiduciary. Those charges continue to be governed by 12 CFR Part 9. Title 12 CFR 7.7515, relating to service charges on dormant accounts, and 12 CFR 7.7517, relating to checking charges by newly organized national banks, remain in effect. The Office is considering amendments to these interpretive rulings and may develop a separate rulemaking proceeding concerning national bank service charges.

Special Studies

A Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required for interpretive rulings such as this where a notice of proposed rulemaking is not required.

A Regulatory Impact Analysis is not required because the OCC has determined that the rule is not a "major rule" as defined by Executive Order 12291.

Notice and Comment

Publication for notice and comment and delayed effectiveness as set forth in the Administrative Procedure

Act 5 U.S.C. § 553 are not required for this document which is an interpretive rule and therefore is exempt (5 U.S.C. 553(b)(A), (d)(2)).

List of Subjects in 12 CFR Part 7

National banks, Service charges, Deposit accounts.

PART 7—[AMENDED]

Accordingly, for the reasons set forth above, Part 7 is amended by revising § 7.8000 as follows:

1. The authority citation for Part 7 reads as follows:

Authority: R.S. 324 et seq., as amended; 12 U.S.C. 1 *et seq.*, unless otherwise stated.

2. By revising 12 CFR 7.8000 as follows:

§ 7.8000 Charges by national banks.

(a) All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or discussion with other banks or their officers.

(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision made by each bank and the Office will not substitute its judgment. In establishing deposit account service charges, the bank may consider, but is not limited to considering:

(1) Costs incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

(4) Maintenance of the safety and soundness of the institution.

(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the amount of that charge. Those laws impair the efficiency of national banks and conflict with the regulatory scheme governing the national banking system and are preempted by federal law.

(d) This interpretive ruling does not apply to (1) charges imposed by a national bank in its capacity as a fiduciary, which are governed by 12 CFR 9; and (2) service charges on dormant accounts which are governed by 12 CFR 7.7515.

Dated: November 28, 1983.

C. T. Conover,

Comptroller of the Currency.

49 Fed. Reg. 28237 (1984)

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 7

[Docket No. 84-23]

Interpretive Ruling Concerning National Bank Service Charges

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: This interpretive final rule amends an earlier interpretive ruling of the Office published on December 2, 1983. This amendment is necessary to clarify some misperceptions regarding the ruling. There is a misunderstanding on the part of some that the ruling itself preempts state laws regarding national bank service charges on deposit accounts. One of the purposes of this amendment is to make clear that this is not the case. Rather, the Office believes that the comprehensive federal statutory scheme enacted by Congress over the years, together with more recent legislative actions deregulating bank deposits, leave no room for states to impose restrictions on national bank deposit account service charges. Some have also expressed concern that the ruling would permit any and all levels of pricing. This amendment additionally makes clear that the Office has the authority to deal with instances of unacceptable pricing.

EFFECTIVE DATE: July 11, 1984.

FOR FURTHER INFORMATION CONTACT: Alan Priest, Attorney, or Joseph Daly, Attorney, Legal Advisory Services Division, (202) 447-1880, Office of the Comptroller of the Currency, Washington, D.C. 20219.

SUPPLEMENTARY INFORMATION:

Background

On December 2, 1983, the Office updated its interpretive ruling, 12 CFR 7.8000 (48 FR 54319), regarding the imposition of service charges by national banks. The ruling was updated in three respects. First, the final rule restated the longstanding Office position that the establishment of deposit account service charges and the amounts thereof are business decisions properly made by bank management. Second, the ruling made clear that in setting deposit account service charges, national banks may consider, but are not limited to considering:

—Recovering costs incurred by the bank in providing the service, plus a profit margin. Absent the ability to recover such costs and receive a profit, banks may be unwilling to provide a given service, thus limiting competition and customer choices.

—Deterring misuse by borrowers. Certain deposit account services provided by banks, such as the honoring of checks drawn against nonsufficient funds, have the potential for misuse. It has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances. Such a practice, if left uncontrolled, provides a customer with automatic loans. Alternatively, the bank could automatically dishonor all checks drawn on nonsufficient funds. A bank, however, may hesitate to do this because of the embarrassment to its customers. An appropriate option, the Office believes, is to establish service charges to be levied in connection with the writing of nonsufficient fund checks by borrowers to discourage customers from frequently writing such checks.

—Enhancing the competitive position and the marketing strategy of the bank. It is the position of the Office

that banks should have the ability to set service charges to encourage or discourage the use of certain services in line with the bank's goals and corporate requirements.

—Maintaining safety and soundness. Service charges should always be established with consideration of their impact on the financial health and profitability of the bank.

Third, the rule stated our opinion that federal law preempts state laws that prohibit or limit service charges on deposit accounts, with specified exceptions.

Two phrases in the existing rule have created confusion and uncertainty. First, the language in subsection (b) that "the Office will not substitute its judgment" has been misconstrued to mean that the Office will not review the level of service charges imposed by banks. That was not the intent, and the apparently misleading language is amended by this final rule. The Office fully recognizes its statutory, regulatory, and supervisory authority and responsibility to deal with instances of improper banking practices. The Office will continue to review all banking practices, primarily through its examination process, and to take appropriate action when warranted.

Second, the preemption language in subsection (c) has been misconstrued to imply that the interpretive ruling itself preempts state law. That is not the opinion of the Office regarding either the state of the law or the effect of the interpretive ruling. Language has been added to the rule indicating that it is the comprehensive federal statutory scheme governing the deposit-taking function of national banks (including recent federal laws deregulating deposit accounts) that preempts state laws that prohibit or limit the amount of a national bank's deposit account service charges.

Special Studies

A Regulatory Flexibility Analysis under the Regulatory Fexibility Act is not required for interpretive rulings such as this where a notice of proposed rulemaking is not required.

A Regulatory Impact Analysis is not required because the Office has determined that the rule is not a "major rule" as defined by Executive Order 12291.

Notice and Comment

Publication for notice and comment and delayed effectiveness as set forth in the Administrative Procedure Act 5 U.S.C. 553 are not required for this document which is an interpretive rule and therefore is exempt (5 U.S.C. 553(b)(A), (d)(2)).

List of Subjects in 12 CFR Part 7

National banks, Service charges, Deposit accounts.

PART 7—[AMENDED]

Accordingly, for the reasons set forth above, Part 7 is amended by amending § 7.8000 as follows:

1. The authority citation for Part 7 reads as follows:

Authority: R.S. 324 *et seq.*, as amended; 12 U.S.C. 1 et seq., unless otherwise stated.

2. By revising paragraphs (b) and (c) of 12 CFR 7.8000 as follows:

§ 7.8000 Charges by national banks.

* * * * *

(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness. In es-

tablishing deposit account service charges, the bank may consider, but is not limited to considering:

(1) Costs incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

(4) Maintenance of the safety and soundness of the institution.

(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the amount of that charge. Such state laws are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks.

* * * * *

Dated: March 19, 1984.

C. T. Conover,

Comptroller of the Currency.

APPENDIX J

Comptroller's Handbook For National Bank Examiners

Introduction

General Introduction Section 1.1

This handbook is designed to aid the examiner in planning and conducting bank examinations. Although it discusses selected areas of banking in general terms, it is primarily oriented toward describing examination procedure and should not be viewed as a comprehensive training guide. Separate training programs covering every area in this handbook will provide more detailed instructions to assist the examiner in better understanding banking operations and the application of the examination procedures. The overall objective of the handbook is to organize and formalize long-standing examination objectives and procedures that will provide guidance to the examiner and enhance the quality and consistent application of examination procedures. Accordingly, this handbook provides specific guidelines for:

- Determining the scope of general and specialized examinations.
- Determining the procedures to be used in the examination of all areas of a bank, including those that may lead to the early detection of trends which, if continued, might result in a deterioration in the condition of a bank.
- Evaluating the adequacy of the bank's written policies and procedures, the degree of compliance with them, and the adequacy of its internal controls.
- Evaluating work performed by internal and external auditors.

- Evaluating the performance and activities of management and the board of directors.
- Preparing working papers that support examination reports and aid in the evaluation of work perfermed.
- Using objective criteria as a basis for an overall conclusion and resulting comments and criticisms of the condition and quality of the bank and its management.

The Office of the Comptroller of the Currency (OCC) is responsibile for promoting and assuring the soundness of the country's system of national banks. The bank examination process is the OCC's fact-finding arm in discharging that responsibility. The essential objectives of an examination are: (1) to provide an objective evaluation of a bank's soundness; (2) to permit the OCC to appraise the quality of management and directors; and (3) to identify those areas where corrective action is required to strengthen the bank, to improve the quality of its performance, and to enable it to comply with applicable laws, rulings and regulations. The evaluation of the prudency of practices, adherence to laws and regulations, adequacy of liquidity and capital, quality of assets and earnings, nature of operations, and adequacy of internal control and internal audit are among the procedures utilized to accomplish those objectives.

Although everything that either weakens or has the potential to weaken the condition of any national bank is of interest to and should receive the attention of the OCC and its staff, the primary concern of the former is the soundness of the National Banking System. Under ideal circumstances, therefore, the examiner's role is to make a qualitative analysis of the condition of the bank under examination. Accordingly, the scope of an examination may embrace every phase of banking activity, or it may concentrate on specific areas which deserve greater em-

phasis because of their potential impact on a bank's soundness.

* * * *

The handbook should also serve as a working tool rather than a reference manual. Examination procedures, verification procedures and internal control questionnaires are excerpted directly from the handbook to form the work programs used to examine a particular bank.

* * * *

Bank management, bank directors and the OCC all have individual and unique responsibilities to the National Banking System. The procedures in this handbook are consistent with an overall program that encourages those parties to meet their responsibilities. The role of the OCC as a supervisory agency and the nature of bank operations form the foundation for the material in each section.

* * * *

Deposit Accounts

Introduction Section 301.1

Deposits represent funds which bank customers have advanced and the bank is obligated to repay on demand or after a specific period of time. Deposits are the major source of employable funds available to a bank, therefore, it is important for a bank's management to implement programs to retain and expand the bank's deposit base and to monitor its character and volatility.

Bankers place great significance on deposit growth and structure since favorable operating results are dependent, in part, on an expanding, stable deposit base. Because of competition for funds, the need of most individuals and corporations to minimize idle funds and the effect of disintermediation on a bank's deposit base, bank management must adopt and implement a development and retention program for all types of deposits. Management must also establish a procedure for determining the volatility

and the character of the deposit structure so that funds can be employed properly while accommodating their potential for withdrawal.

The examination process will analyze the deposit development and retention program and methods used to determine the volatility and character of the deposit structure.

The deposit development and retention program includes:

- A marketing strategy.
- Projections of deposit structure and associated costs.
- A formula for comparing results against projections.
- A system for revising the plan when necessary.

* * * *

The examiner analyzes the character of the overall deposit structure. The information gathered in the various examination procedures should be sufficient to allow the examiner to judge the character of both volatile and hard core deposits. It is important that bank management be informed of the character of the deposit structure on a periodic basis by internal reports. Management's lack of such knowledge, could lead to the unwise employment of funds with problems arising at a later, inopportune date. Ultimately, the examiner should be satisfied that management has properly planned for the bank's future.

It would be impossible for an examiner to review each individual deposit account during the course of an examination. Accordingly, the examiner's efforts should be directed to those types of deposit accounts shown by experience to be most significant relative to the examination objectives. The following paragraphs discuss common types of deposit accounts that, under certain circumstances can become major problems.

* * * *

The size, frequency and duration of deposit account overdrafts are matters that should be governed by bank policy

and controlled by adequate internal controls, practices and procedures. Overdraft approval authority should be assigned in the same manner as is lending authority and should never exceed the employee's lending authority. Systems for monitoring and reporting overdrafts should emphasize a secondary level of administrative control that is distinct from other lending functions so that account officers who are less than objective do not allow influential customers to exploit their overdraft privileges. Overdraft charges should discourage frequency [sic] usage but penalty fees should never be considered an important source of income.

* * * *

Deposit Accounts

Examination Objectives Section 301.2

1. To determine if the policies, practices, procedures and internal controls regarding deposit accounts are adequate.

2. To determine if bank officers are operating in conformance with the established guidelines.

3. To evaluate the deposit structure and determine its character and volatility.

4. To determine the scope and adequacy of the audit function.

5. To determine compliance with applicable laws, rulings and regulations.

6. To initiate corrective action when policies, practices, procedures or internal controls are deficient or when violations of laws, rulings or regulations have been noted.

* * * *

Deposit Accounts

Examination Procedures Section 301.3

1. Complete or update the Deposit Accounts section of the Internal Control Questionnaire.
2. Based on the evaluation of internal controls and the work performed by internal/external auditors (see separate program) determine the scope of the examination.
3. Test for compliance with policies, practices, procedures and internal controls in conjunction with performing the remaining examination procedural steps. Also obtain a listing of any deficiencies noted in the latest review done by internal/external auditors from the examiner assigned "Internal and External Audits," and determine if appropriate corrections have been made.
4. Perform appropriate verification procedures.
5. Obtain or prepare, as applicable, the following listed reports. On an automated system, the examiner should use available bank copies of printouts plus transactions journals, microfiche or other visual media to minimize expense to the bank. The examiner should be guided by the minimum standards of output for data processing systems in deciding what information is available. On a manual system, the information necessary to complete the examination procedures and indicated verification procedures is left to the examiner's discretion.

   a. For demand deposits:

      - Trial balance.
      - Overdrafts.
      - Unposted items.
      - Dormant accounts.

- Public funds.
- Trust department funds.
- Uncollected funds.
- Due to banks.
- Average balance.
- Significant change.
- Demand certificates of deposits.
- Large balance report.

* * * *

10. Evaluate the effectiveness of procedures regarding overdrafts and drawings against uncollected funds by:

    a. Reviewing procedures and policies for extensions of credit by such methods to determine that:

        - Officer approval limits have been established.
        - A formal system of review and approval is in effect.

    b. Ascertaining the adequacy of the bank's policies and reporting methods regarding drawings against uncollected funds by determining that:

        - The uncollected funds report reflects balances as uncollected until they are actually received.
        - Management is effectively comparing reports of significant changes in balance and activity volume to uncollected funds reports.
        - Management knows the reasons why a depositor is frequently drawing against uncollected funds.
        - A reporting system to inform senior management of significant activity in this area has been instituted.

- Appropriate employees clearly understand the mechanics of drawing against uncollected funds and the risks involved, especially in the area of potential kiting operations.

c. Determining whether formal overdraft agreements exists and, if so:

- Obtain trial balance or list of the agreements.
- Cross-reference trial balance or list to credit line slips of various loan departments.
- Work credit files on significant formal agreements not crossed above.

d. Performing the following:

- Cross-reference overdraft and uncollected funds reports to credit line slips of the various loan departments.
- Work credit files on significant overdrafts and depositors who frequently draw significant amounts against uncollected funds not crossed above.
- Request management to charge uncollectable overdrafts to the reserve for possible loan losses.
- Submit a list of overdrafts considered loss and the total amounts overdrawn 15 days or more to the examiner assigned "Loan Portfolio Management."

11. Review the bank's deposit development and retention policy to determine if the scope includes:

a. A marketing strategy that includes:

- Advertising.
- Goods and services offered as inducements to potential deposit customers.

- Competitive rates.
- Indication of types of deposits desired, such as time and/or demand deposits of individuals, corporations or public entities.

b. Projections of anticipated deposit structure and interest costs of such a structure, indicating percentages of time and demand deposits of:

- Individuals.
- Corporations.
- Public entities.

c. A periodic comparison of performance to

- Estimated interest expense for new deposits and shifts from demand deposits.
- Service charge fee schedule.
- Estimated service charge income.
- Estimated processing costs.
- Changes in reserve requirements.

b. Comparing the volume of the automatic transfer accounts and resulting income and expenses to budgeted accounts. Significant variances should be investigated.

c. Preparing a memorandum for examiners performing "Funds Management" and "Analytical Review of Income and Expense" on the effects of automatic funds transfer accounts on the bank. This memorandum should address the following:

- Volume of new deposits.
- Significance of shifts in existing deposits attributable to the automatic funds transfer accounts.
- Income earned from service charges.

- Expenses incurred from processing entries to the accounts.
- Yields on assets funded by automatic transfer accounts.
- Accuracy and quality of management's planning regarding the service.

* * * *

17. Obtain information on competitive pressures and economic conditions from the examiner assigned "Overall Conclusions," and evaluate that information, along with current trends in deposits and present marketing techniques, to estimate their affect [sic] on the bank's deposit structure.

18. Test for compliance with applicable laws, rulings and regulations by performing the following for:

* * * *

i. *12 CFR 7.8000—Charges by Banks:*
Inquire into service charge calculations of competing banks to determine if charges in the marketing area are arrived at in a competitive manner.

* * * *

19. Discuss findings with appropriate officer(s) and prepare report comments on:

a. Policy deficiencies.

b. Weaknesses in supervision.

c. Apparent violations of laws, rulings and regulations and the potential personal liability of the directorate.

* * * *

Review the bank's internal controls, policies, practices and procedures for demand and time deposit accounts. The bank's systems should be documented in a complete and concise manner and should include, where appropri-

ate, narrative descriptions, flowcharts, copies of forms used and other pertinent information. Items marked with asterisks require substantiation by observation or testing.

* * * *

Overdrafts

22. Are officer overdraft limits formally established?

*23. Is an overdraft listing prepared daily?

*24. Is that listing circulated among the officers?

*25. Do overdrafts require the approval of an authorized officer?

26. Are the statements of larger overdrawn accounts reviewed for irregularities?

27. Is a record of overdrafts included in the monthly reports to the board of directors or its committee?

28. Is there an established schedule of service charges?

Other

* * * *

*34. For returned checks, unposted items and other rejects:

a. Are daily listings of such items prepared?

b. Are all items reviewed daily and is disposition of items required within a given time period (if so, indicate time period ————————)?

*35. For uncollected funds:

a. Does the bank receive or prepare a daily report of drawings against uncollected funds?

b. Does an authorized officer review that report?

c. Must an officer approve any draw against uncollected funds?

* * * *

Demand Deposit Conclusion

40. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls or other circumstances that impair any controls or mitigate any weaknesses indicated above (explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures)?

41. Based on a composite evaluation, as evidenced by answers to the foregoing questions and those relating to demand deposits included in the general section, internal control of demand deposits is considered ———— (good, medium or bad).

* * * *

Deposit Accounts

Verification Procedures Section 301.5

* * * *

2. Using appropriate techniques, sample the entire deposit structure as a single population and select deposits of all types from the trial balance . . . .

* * * *

3. For demand deposit accounts selected in step 2:

   a. Verify the computation of service charges for at least one account from each type of demand deposit account selected, and trace them to the appropriate income account.

   b. Determine, on a test basis, if insufficient funds and overdraft charges are properly collected and trace them to the appropriate income account.

* * * *

Overall Conclusions Regarding Condition of the Bank

Introduction — Section 503.1

Throughout this handbook, the examiner is encouraged to use objective criteria in evaluating various areas of the bank. However, there will always be a need for subjective judgment in an examination. Formulating an overall conclusion regarding the present and future condition of the bank requires the use of both objective criteria and subjective judgment. As experience is essential in evaluating information in areas requiring subjective judgment, the procedures in this section should be performed by the examiner-in-charge.

In performing those procedures, the examiner's primary concerns are:

- To make the ultimate determination as to:
  - The solvency of the bank and its ability to meet maturing and unusual demands in the ordinary course of business.
  - Adherence to safe and sound banking practice.
  - Adherence to the law.
  - The continued viability of the institution.
- To communicate the results of the examination to the Comptroller of the Currency and the directors of the bank.

The evaluation of the overall condition of the bank is based on conditions found throughout the institution. Considerations include internal control and policy exceptions; violations of law, rulings, and regulations; quality of management; adequacy of earnings and capital; quantities of criticized assets; and other identified deficiencies or irregularities.

An evaluation of the future condition of the bank is based on the analysis of:

- Management's plans as expressed by operating plans, the capital plan, and other projections.
- Factors such as competition and economic conditions.
- The overall present condition of the bank.

* * * *

Overall Conclusions Regarding Condition of the Bank

Examination Objectives Section 503.2

1. To reach conclusions regarding the present condition of the bank.
2. To reach conclusions regarding the future prospects of the bank.
3. To determine the bank's ability to meet demands in the ordinary course of business.
4. To determine the bank's adherence to safe and sound banking practices.
5. To formulate recommended action, when appropriate, based on those conclusions.
6. To communicate conclusions and recommendations both orally and in the examination report.

* * * *

Specialized Examinations and Supervisory Visitations

Introduction Section 700.1

Under 12 USC 481, the Office of the Comptroller of the Currency (OCC) has authority to examine national banks.

Examinations are meant to:

- Provide an objective evaluation of a bank's soundness.

- Permit the OCC to appraise the quality of management and directors.
- Identify areas where corrective action might be required to strengthen the bank, to improve the quality of its performance and to enable it to comply with applicable laws, rules and regulations.

The OCC believes that those objectives can be met on a timely basis through the use of two different types of examinations: General examinations and specialized examinations.

The general examination consists of the standard examination procedures outlined in this handbook. Since no two banks are exactly identical, national bank examiners, drawing on their professional judgment, may modify standard procedures contained in this handbook during general examinations.

The procedures developed for general examinations in the other sections of this handbook embrace every phase of banking activity. The OCC has decided that their periodic application in general examinations is necessary to properly discharge its duty in the administration and supervision of national banks. However, the OCC has decided that the use of those procedures in each examination is neither necessary nor desirable in most cases. In arriving at that decision, the OCC considered the benefit of the more extensive general examination procedures and the reliance that can be placed on the NBSS to identify changing situations in the banking industry and in individual banks. The OCC also recognized the benefits of periodic examinations of trust departments, EDP departments, international departments and consumer affairs in developing the minimum scope of the complimentary specialized examination.

* * * *

Specialized Examinations

Examination Procedures Section 700.3

1. Review the contents of this program and prepare a staff assignment and time budget. This should be done by the examiner-in-charge prior to starting the examination.
2. Review the working papers of previous general examination and any subsequent specialized examination.
3. Review the report for the most recent general examination and any subsequent specialized examination and:
   a. Determine that all significant deficiencies noted have been corrected or determine why corrective action was not initiated.

* * * *

22. For deposit accounts:
   a. Review the reconcilement of all types of deposit accounts including official checks. Compare the balances to department controls and the general ledger, and determine:
      - If reconciling items are reasonable.
      - The propriety of adjusting entries.
      - Disposition of reconciling items.
   b. Review recent reports of overdraft and drawings against uncollected funds and investigate any large, stale or repetitive items to determine loss potential.

* * * *

APPENDIX K

Cal. Civ. Code § 1670.5.

Unconscionable contract or clause of contract; finding as matter of law; remedies

(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

(Added by Stats. 1979, c. 819, p. 2827, § 3, eff. Sept. 19, 1979.)

APPENDIX L

[Cover page and tables omitted]

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Civil No. A013838

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

REPLY BRIEF OF AMICUS CURIAE COMPTROLLER OF THE CURRENCY WITH RESPECT TO THE COMPTROLLER'S INTERPRETIVE RULING

The Court has invited supplemental briefs on the subject of the effect of the amended version of the Comptroller of the Currency's Interpretive Ruling Concerning National Bank Service Charges, 12 C.F.R. 7.8000, promulgated on November 28, 1983.

Before addressing that subject, however, the Comptroller of the Currency thinks it appropriate first to inform the Court that, because there have been misperceptions and misunderstandings regarding the amended ruling, it is the Comptroller's intention to amend further and clarify the ruling so as to make clear the following points:

(a) that it is the federal statutory scheme and Congressional policy to deregulate in the area of

deposit-related banking services that preempts state law, and not the ruling itself;

(b) that the ruling should not be misconstrued as an encouragement to banks to raise prices without regard to prudent banking principles or in an anticompetitive manner; and

(c) that the Comptroller fully recognizes his obligation and authority to ensure that there be adequate protection at the federal level for banking consumers and will take all necessary and appropriate steps to provide consumers with means of redress in cases of egregiously uncompetitive pricing for deposit-related banking services.

This supplemental brief addresses three points: (1) the reason why the interpretive ruling, as amended, was promulgated; (2) the basis for the finding of preemption contained in the ruling; and (3) the effect the ruling has on courts adjudicating issues addressed by the ruling.

I. The Interpretive Ruling Was Promulgated As a Clear Public Statement by the Comptroller on the Subject of National Bank Service Charges.

As this Court is no doubt well aware, there have been a number of lawsuits filed within the past few years, both in the State of California and in other states, (*i.e.*, New York and Oregon) challenging under state law the imposition by national banks of service charges on deposit accounts, specifically charges for non-sufficient funds ("NSF") checks. Because of the amount of state-court litigation against national banks that has arisen on an issue that seems to the Comptroller to be one of a peculiarly federal nature, the Comptroller concluded that it was essential that he state, as a matter of public record, his position on this issue. Indeed, the ruling itself states: "This action is taken in response to disputes, including litigation, which have arisen over deposit account service charges by national banks."

Because the issue of NSF charges has become a focus of dispute and litigation, it is necessary for this Court, other courts faced with similar cases, national banks, and the banking public to be certain of the considered opinion of the Comptroller, as the Administrator of National Banks, on important principles relevant to the imposition by national banks of NSF and other deposit-related service charges. This Court has, of course, been apprised of the Comptroller's position on this issue through the *amicus* briefs filed in this case both in the Appellate Division and in this Court. The Comptroller there stated, and reaffirms here, that state law may not control or dictate the manner or exercise of the deposit-taking power of national banks, including the application of service charges. That is so because the existing federal legal framework has already occupied the field. If state law should be used in an attempt to exercise control over national banks in this area, that law would be preempted by the national banking statutory scheme enacted by Congress. The amended ruling does not say anything that had not already been said in those briefs.

The significance of the ruling for this Court, however, is not so much what the ruling says, as that the Comptroller chose to promulgate it in the first place. The act of promulgation is significant for two reasons. First, it was intended to demonstrate the Comptroller's firm commitment to the principles enunciated in the *amicus* briefs; this was not an *ad hoc* position taken simply to aid a defendant in a lawsuit, but a matter of importance to the entire national banking system. To demonstrate this, the Comptroller chose not simply to speak through briefs in a particular lawsuit, but to make a public pronouncement of general application. This underscores the fact that the Comptroller's stand in this case is not taken for the benefit of a particular bank, but for the well-being of the national banking system as a whole.

Indeed, the principle that underlies the Comptroller's ruling, that service charges should be determined by mar-

ket forecs and not by judicial rate-making, is a principle that was recognized by the Comptroller's office over twenty years ago. For example, in a letter to the Chairman of the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations of the U.S. House of Representatives, dated November 5, 1963 (Appendix A hereto), Comptroller James J. Saxon said:

> This Office takes the position in regard to bank service charges that this is a matter to be governed by banking judgment as controlled by competitive factors in the arena in which the banks operate. If a particular bank imposes service charges that are too high, a rival bank would be able to take away a great deal of its business by offering a lower rate. Inasmuch as our society is grounded on the principle of free competition, strong competitors rather than government regulation in the local banking picture are the surest safeguards against arbitrary and unreasonable charges by an individual institution.

Second, the promulgation of the ruling reinforces the strong federal interest in the ability of national banks to exercise their federally granted deposit-taking authority free from interference by application of state law. It is important to recognize, moreover, that it is precisely because this is a matter of federal concern, and an area substantially occupied by Congress [1] and entrusted to the administrative purview of the Comptroller, that it was appropriate for the Comptroller to issue his ruling.

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[1] The Comptroller does not contend that state laws dealing with deposit-taking that do not intrude on Congressional intent to deregulate service charges for deposit accounts or that do not interfere with the banks' deposit-taking authority are preempted. For example, the Comptroller does not quarrel with the ruling in *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944), where the Supreme Court held that a state statute on the treatment of dormant accounts was held applicable to national banks precisely because it did not interfere with the deposit-taking function of the banks.

There has been some suggestion by appellant and his allied *amici* herein that the interpretive ruling was promulgated for the purpose of attempting improperly to influence this Court or affect the outcome of this litigation. This allegation apparently finds its basis in the timing of the rule's publication, which took place shortly before the date of oral argument before the Court.

There was nothing sinister, or even dubious, in the timing of the promulgation of the rule. Surely, even those complaining must realize that such interpretive rulings do not spring into being overnight; indeed, the Comptroller had made the decision to issue such a ruling, and directed that its preparation be undertaken, some four months prior to its date of publication. The timing of its publication was due to the inevitable time-consuming tasks and procedures inherent in the routine drafting and review process common to all such administrative activities. Nevertheless, it was certainly the intention of the Comptroller to have the ruling a matter of public record prior to the date of oral argument before this Court since it was important for the Court in its consideration of this cause to understand that the Comptroller's stand as *amicus* herein is the policy of the Comptroller for administering all banks nationwide, consistent with Comptroller Saxon's pronouncement twenty years ago, and not merely a matter of convenience to a particular litigant.

II. The Interpretive Ruling Confirms the Comptroller's Position that State Law that Purports to or Has the Effect of Regulating Deposit-Related Service Charges by National Banks Is Preempted.

An important aspect of the interpretive ruling, one which has generated the most discussion in this forum, is the conclusion stated by the Comptroller in the ruling that the amounts of deposit-account service charges imposed by national banks may not be limited, restricted or prohibited by state law. This is so because attempts by

states to regulate in this area are preempted as being in conflict with the statutory scheme under which the national banking system is regulated.

The statement on preemption contained in the interpretive ruling should surprise no one, least of all the parties to the instant lawsuit, for it is precisely the same position taken by the Comptroller in his *amicus* briefs previously filed both in this Court and in the court below. The arguments in those two briefs are well known to the Court and will not be repeated here; it is sufficient here to note that the Comptroller's participation as *amicus* in this case has been for the specific purpose of presenting to the Court sound arguments why state law is preempted insofar as it purports or is used to regulate the amount of the service charges that national banks may impose on deposit accounts. The interpretive ruling reaffirms those very same arguments.

The petitioner and other *amici* herein have taken advantage of this Court's willingness to receive further briefing on the subject of the effect of the interpretive ruling to reargue the preemption question. The Comptroller believes that this subject has been adequately addressed in the previous rounds of briefing in this case, and will not use this brief as a vehicle to reargue that point. However, the Court should be advised here that the view of preemption set forth by the Comptroller both in his *amicus* briefs and in his interpretive ruling is squarely in accord wth the most recent court decisions on preemption in the banking area.

In *Fidelity Federal Savings & Loan Assn. v. de la Cuesta*, 458 U.S. 141 (1982), the Supreme Court found that the Federal Home Loan Bank Board's due-on-sale regulations preempted conflicting California state limitations on due-on-sale practices. While *de la Cuesta* was decided by the Court on the basis of an actual conflict between valid federal regulations and state law, the Court

was also instructive with respect to the question of Congress' occupation of a field, thereby superseding state law. The Court stated:

> The pre-emption doctrine, which has its roots in the Supremacy Clause, U.S. Const, Art VI, cl 2, requires us to examine congressional intent. Preemption may be either express or implied, and "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." Jones v Rath Packing Co., 430 US 519, 525, 51 L Ed 2d 604, 97 S Ct 1305 (1977). Absent explicit pre-emptive language, Congress' intent to supersede state law altogether may be inferred because "[t]he scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," because "the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject," or because "the object sought to be obtained by federal law and the character of obligations imposed by it may reveal the same purpose." Rice v. Santa Fe Elevator Corp. 331 US 218, 230, 91 L Ed 1447, 67 S Ct 1146 (1947).

458 U.S. at 152-153.

The Court in *de la Cuesta* thus recognized that a finding of Congressional occupation of a field is not dependent upon an explicit statement of Congress that it is superseding state law on a particular topic, but may be inferred from a pervasive scheme of federal statutory and regulatory action and from a clearly predominant federal interest in the field. Such federal preeminence is clearly present in the general field of regulation of the rates and charges of national banks, as well as in the specific field of service charges on deposit accounts. As demonstrated in the Comptroller's opening *amicus* brief in this cause,

such preemption may be inferred from the pervasive federal statutory and regulatory scheme governing national banks, as found in the National Bank Act, 12 U.S.C. §§ 21-215, together with the strong Congressional interest in the opening of deposit-related banking services to the free play of market forces, as evidenced by such recent legislation as the 1980 Depository Institutions Deregulation and Monetary Control Act, Pub. L. 96-221, 94 Stat. 132, and the 1982 Garn-St. Germain Act, Pub. L. 97-320. It is simply Constitutionally abhorrent for the states to attempt to reregulate, whether by statute or by judicial rate-making, what Congress has chosen to deregulate.

The *de la Cuesta* decision is significant for still another reason. The Court there struck down an attempt to use a state law principle of general application, the Wellenkamp doctrine, to regulate an area, when such regulation by judicial fiat conflicted with a clear federal interest. The Wellenkamp doctrine is simply the "unconscionability" premise of this case under a different name. It is submitted that, in light of the *de la Cuesta* ruling, such state law principles as have been propounded in this case must give way to the overriding federal interest in the area.

Appellant's attempt to distinguish *de la Cuesta* betrays specious reasoning. Appellant argues that since the Court in *de la Cuesta* based its finding of preemption on a broad delegation of power by Congress to the Federal Home Loan Bank Board, there can be no preemption here because there has been no delegation of power to federal agencies regarding the specific topic of service charges. Appellant's Reply Brief at 17-18. That argument is a *non-sequitur*; the broad delegation of power to the Bank Board bears no relation to a narrow delegation of power with respect to such a limited area as service charges. Indeed, appellant's argument might be somewhat comprehensible if the Supreme Court had found it necessary to find an explicit delegation on the subject of due-on-sale clauses, a subject more nearly akin to service charges.

But the Court found it sufficient for preemption purposes to find a general delegation of power to regulate thrifts to the Bank Board. Such a general delegation of power to regulate national banks has been given to the Comptroller, a broad power that encompasses even the limited area as service charges, just as the Bank's broad power encompasses such a limited area as due-on-sale.

Also of significance is the recent case of *Conference of State Bank Supervisors v. Conover*, 710 F.2d 878 (D.C. Cir.), decided June 30, 1983. In that case, the U.S. Court of Appeals for the District of Columbia found that the Comptroller's regulations on adjustable-rate mortgages preempted inconsistent state laws. The decision is significant for two reasons.[2] First, the court stated that the teachings of the *de la Cuesta* opinion were applicable to national banks, and were not limited only to savings and loan institutions. Secondly, and most importantly, the court stated:

> It bears repeating that the entire legislative scheme [on the powers of national banks] is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of national banks, therefore, the Comptroller has the power to preempt inconsistent state law.

Id. at 885.

The court in that recent case, therefore, reaffirmed the preeminence of the federal legislative scheme in the regu-

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[2] Because this case turned on a conflict between state law and regulations of the Comptroller, and not the question of Congressional occupation of an area or the effect of an interpretive ruling, the Comptroller does not contend that this case is directly controlling here.

lation of national banks, and underscored the fact that state law shall not be allowed to intrude on that legislative scheme mandated by Congress.

III. The Interpretive Ruling Is Entitled to Due Deference as an Official Pronouncement of the Federal Regulator with Congressionally Mandated Authority for the Administration of the National Banking System.

The rule addressed by this brief, 12 C.F.R. § 7.8000 as amended, is by its very terms an interpretive rule. The significance for this Court of that fact may be discerned from the following statement by the U.S. Court of Appeals for the District of Columbia Circuit in *Guardian Federal Savings and Loan Assn. v. Federal Savings and Loan Ins. Corp.*, 589 F.2d 658 (1978):

> Although the term "interpretive rule" is not expressly defined by the [Administrative Procedure Act], its essential meaning is readily distinguished from that of a "substantive" or "legislative" rule. A substantive or legislative rule has the force of law; an interpretive rule is merely a clarification or explanation of an existing statute or rule. The Attorney General's Manual defines interpretive rules as "rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers." Judicial review of a substantive or legislative rule is limited by the provisions of APA section 706, but a court is free to make an independent inquiry into the correctness or propriety of an interpretive rule, although substantial deference is accorded to the agency's interpretation. . . .

Id. at 664-665 (footnotes omitted).

The Comptroller wishes to make clear to the Court that he does not propose that his interpretive rule be given the force of law; he does respectfully submit, however, that the rule should be accorded the substantial deference due his interpretation of the federal statutory scheme which it is his mandate to administer. And it is that statutory scheme, and not the ruling itself, that preempts state law.[3]

It is a longstanding principle that courts will give deference to statutory interpretations made by agencies with peculiar expertise in the area in question. This was first clearly enunciated by the Supreme Court in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). There the Court, first noting that it "has long given considerable and in some cases decisive weight" to agency interpretive regulations, stated that such interpretations, ". . . while not controlling on the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance." *Id.* at 140. In *Griggs v. Duke Power Co.*, 401 U.S. 424, 433-34 (1971), the Court reaffirmed that the administrative interpretation of a federal statute by the enforcing agency is entitled to great deference, especially when the statute and legislative history support the agency's construction. *See also Whirlpool Corp.* v. *Marshall*, 445 U.S. 1, 11 (1980) (Interpretive regulation entitled to deference unless it can be said not to be a reasoned and supportable interpretation of the underlying statute).

Appellant and other *amici* argue that the Comptroller's ruling does not find support in Congressional intent or

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[3] The Court should also understand that the Comptroller is not stating that this Court is without jurisdiction in this case, but rather that the Court cannot apply state law to questions involving the deposit-taking authority of national banks, since such state law has been preempted by Congressional action in this area.

legislative history, making much over the fact that members of the Comptroller's staff had, during the 1970's, issued opinions that purportedly run counter to the Comptroller's position in the interpretive ruling. Their point apparently is that, since the interpretive ruling is allegedly at odds with these opinion letters, the ruling is not entitled to deference by the Court.

This argument fails for three reasons. First, it is self-evident that in any conflict between an opinion letter by a staff member and a formal interpretive ruling promulgated by the Comptroller, the latter will be controlling. Second, the argument does not take into account the 1963 statement of then-Comptroller Saxon, discussed *supra* at p. 4, that indicates that the policy behind the interpretive ruling had been recognized over twenty years ago. Third, the argument ignores the fact that, since the time those opinion letters were issued, Congress has spoken in unequivocal terms in favor of the deregulation of the area of deposit-taking, through passage of such watershed legislation as the Depository Institutions Deregulation Act and the Garn-St. Germain Act. Prior to this deregulatory legislation, Congressional activity in the area of deposit-taking had largely been limited to the regulation of interest rates. By the same token, there has been no historic trend for states to interfere in banks' deposit-taking function, and consequently very few preemption cases have arisen in this area. Thus, even if there had been any doubt that Congress had occupied this area, this recently enacted statutory scheme, supplanting governmental rate-making with pricing by free market forces, should dispel those doubts. It is this clear Congressional deregulation of the area of deposit-taking by financial institutions that underlies the Comptroller's interpretive ruling.

In addition to the foregoing, the Court should consider the economic and regulatory context of the ruling. In recent years, as a result of a long and pervasive economic

recession, there have been a greater number of problem banks, a greater number of bank failures, and lower bank earnings than had been seen for many years. These institutions are now faced with the prospect of profits being squeezed by declining margins due largely to deregulated deposit rates. In partial response to this economic setting, the Comptroller has exhorted banks to develop an approach to fee income that would include offering new products and services and taking steps to eliminate the cross-subsidization of unprofitable products and services. Thus, by reason of the Comptroller's enunciated policy, fee income has become a much more significant factor in a bank's revenue base. The Comptroller's position that such fee income should depend upon market forces and not judicial rate-making is thus both reasonable and consistent when seen in context.

Finally, it has been argued that the interpretive ruling should be ignored because of procedural flaws in its promulgation, *i.e.*, that it was not subjected to a notice and comment period prior to adoption. That argument is misplaced.

The Administrative Procedure Act ("APA") has established certain notice and comment requirements that a federal agency must satisfy prior to the promulgation of a substantive regulation. 5 U.S.C. § 553. However, Congress in the APA expressly stated that agency activities other than the promulgation of substantive regulations need not comply with these notice and comment requirements. The issuance of an interpretive ruling is one agency activity expressly exempt from these statutory requirements. 5 U.S.C. § 553(b)(3)(A).

The Comptroller's ruling, as noted *supra* at p. 11, is by its own terms and by its intended operation an interpretive ruling and therefore within the exception to the notice and comment requirements of the APA. Appellant,

however, argues that this Court should view this interpretive ruling as an illegally promulgated substantive regulation. Appellant asserts that due to the "substantial effect" this interpretive ruling will have upon customers of national banks in California, it must be viewed as a substantive regulation and therefore subject to the APA notice and comment requirements.

In a recent decision, the U.S. Court of Appeals for the District of Columbia held that a substantial effect analysis is *not* the correct test for a court to apply when faced with the question of whether an agency action is an interpretive ruling or a substantive regulation. "Simply because agency action has substantial impact does not mean it is subject to notice and comment if it is otherwise expressly exempt under the APA." *Cabais v. Egger*, 690 F.2d 234, 237 (D.C. Cir. 1983). The court there reiterated that the proper test for resolving the substantive-interpretive dichotomy is found in *Gibson Wine Co. v. Snyder*, 194 F.2d 329, 331 (D.C. Cir. 1982):

> Generally speaking, it seems to be established that regulations, substantive rules, or legislative rules are those which create law, usually implementary to an existing law; whereas interpretive rules are statements as to what the administrative officer thinks the statute or regulation means.

Cabais v. Egger, 690 F.2d at 238 (quoting *Gibson Wine Company v. Snyder*).

Applying this test so recently reaffirmed by the D.C. Circuit, the Comptroller's ruling must be viewed as a validly adopted interpretive ruling. By promulgating this ruling the Comptroller does not purport to create law, but to state for broad application his position on what existing law demands.

Dated: January 27, 1984

Respectfully submitted,

COMPTROLLER OF THE CURRENCY
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[Appendix A, letter from John T. Simon, Comptroller of the Currency, dated November 4, 1983, and proof of service and service list omitted]

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Civil No. A013838

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

BRIEF OF AMICUS CURIAE COMPTROLLER OF THE CURRENCY

INTRODUCTION

The office of the Comptroller of the Currency (the "Comptroller"), a bureau of the United States Treasury Department, is the agency charged by Congress with the supervision and regulation of more than 4,500 national banks.[1] The Comptroller submits this brief as *amicus curiae* concerning federal policy in the area of free market competition for banks. When this case was before the California Court of Appeal the Comptroller filed an *amicus curiae* brief. For the reasons set forth in that brief and below, the Comptroller urges this Court to deny the present petition for hearing.

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[1] The Comptroller, *inter alia*, charters new banks, 12 U.S.C. § 27, examines banks, 12 U.S.C. § 481, approves branches, 12 U.S.C. § 36, and, when necessary, exercises enforcement authority, 12 U.S.C. § 1818.

ARGUMENT

The plaintiff in this case contends that, even assuming that the defendant bank has formed valid contracts under state law for the collection of NSF charges from its depositors, and conceding that these charges are fully disclosed to consumers and are in line with the market price for such charges generally, the state courts may under the doctrine of "unconscionability" inquire into the "reasonableness" of the charges in relation to the bank's "costs." If carried to this novel extreme, the doctrine of unconscionability is no longer solely a matter of state contract law, but instead becomes a question of regulatory policy affecting national banks, as to which the Federal government has a supervening policy interest. It is the Comptroller's position that *ad hoc* judicial inquiry into the reasonableness of the profit that a national bank earns in the course of its banking business is contrary to Federal policy that free marketplace competition should principally determine the level of pricing of a national bank's deposit-related charges.

Congress, by enacting the national banking laws, intended that national banks should be able to operate effectively in the competitive marketplace.[2] This Congressional intention, as reaffirmed by recent amendments to the national banking laws, sets forth a federal policy that national banks should be able to compete in the free marketplace without undue regulatory restraints.[3] Free market competition should be the principal determining

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[2] The antitrust laws ensure that competition exists in the marketplace. "Subject to narrow qualifications, it is surely the case that competition is our fundamental national policy . . . ." *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 372 (1963).

[3] Interpretive Ruling 8000 provides: All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, undertaking, understanding or even discussion among banks or their officers. 12 C.F.R. § 7.8000.

factor in the level of pricing by a national bank for its services, particularly where, as the Court of Appeals noted here, the charges are *fully disclosed. Perdue* v. *Crocker National Bank*, Civil No. 46808, slip op. at 11. Consequently, deposit-related charges, such as charges for checks returned NSF, should be determined by a national bank's assessment of the competitive marketplace and not by statutory or judicial direction.

Banking has been and continues to be a "highly regulated industry because of the unique role banks play in the economy." *Competition and Conditions in the Financial System, Hearings before the Senate Committee on Banking, Housing, and Urban Affairs*, 97th Cong., 1st Sess. 56 (1981) (hereinafter "*Competition and Conditions in the Financial System*") (Statement of Frederick H. Schultz, Vice Chairman, Board of Governors of the Federal Reserve System). Banks are regulated in the area of market entry and product and geographic diversification; under "prudential" regulations designed to insure the safety and soundness of financial institutions; in the area of reserve requirements and other restrictions related to the conduct of monetary policy; and in the area of consumer protection under legislation passed to insure important consumer rights, and to deal with the perceived inequities in the provision of financial services to women, minorities and low and moderate income individuals." *Id.* This extensive network of regulation, which represents Congress's balancing of the multiple interests and policies involved, affords meaningful and significant protection to consumers.

Over the past five years Congress has conducted an exhaustive inquiry into major banking laws and the competitive and financial condition of the nation's financial system.[4] A central finding of these hearings was

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[4] In addition to *Competition and Conditions in the Financial System, supra, see, e.g., The Consumer Checking Equity Act of 1979, Hearings before the Subcommittee on Financial Institutions Super-*

that while a considerable degree of regulation is necessary and appropriate, direct regulation of *price* within the financial system had produced waste and inefficiency, and that a competitive marketplace would produce a better allocation of products, services and prices to the ultimate benefit of consumers. These hearings resulted in the enactment of two omnibus banking statutes that reflect Congress's commitment to this principle.

In 1980, Congress enacted the Depository Institutions Deregulation and Monetary Control Act, Pub. L. 96-221, 94 Stat. 132 ("1980 Act"). The 1980 Act, *inter alia*, authorized banks and federal savings and loan associations to offer interest bearing checking accounts (commonly known as NOW accounts), and provided for the phasing-out of interest-rate ceilings on savings and time deposits by 1986, under the guidance of the newly created Depository Institutions Deregulation Committee (DIDC). A principal purpose of the 1980 Act was to promote competitive equality among depository institutions and enable them to compete with other financial service providers on the basis of price. S. Rep. 368, 96th Cong., 2d Sess. 6, *reprinted in* 1980 U.S. Code Cong. & Ad. News 241. Commenting on the impact of the 1980 legislation, Vice Chairman Frederick H. Schultz of the Board of Governors of the Federal Reserve System testified:

> The [1980 Act] has radically changed the possibility for "regulation" through the pressures of a competitive marketplace, rather than governmental action. The number of institutions offering bank-

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vision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, 96th Cong., 1st Sess. (1979); *Financial Institutions in a Revolutionary Era: Hearings before the House Committee on Banking, Finance and Urban Affairs*, 97th Cong., 1st Sess. (1981); *Financial Institutions Restructuring and Services Act of 1981, Hearings on S. 1686, S. 1703, S. 1720 and S. 1721 before the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. (1981).

> like services to consumers has been increased by the legislation from about 14,000 to about 40,000.
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> * * * *
>
> Competition to attract deposits, to make loans, and to provide other financial products will encourage the provision of services and information that many bank customers need and are willing to pay for.

Competition and Conditions in the Financial System, *supra*, at 55.

In enacting the 1980 Act, Congress recognized that "[t]ransition to a more competitive climate is always painful" but put "all institutions on notice that change is inevitable—that savers are eventually going to realize a market rate of return and that plans must be made today for competing in the future." S. Rep. No. 368, 96th Cong., 2d Sess. 5, *reprinted in* 1980 U.S. Code Cong. & Ad. News 240. It was also recognized that the transition had profound implications for the safety and soundness of depository institutions,[5] and must proceed with a minimum of disruption:

> [T]echnology, inflation, and the volatility of the marketplace have assured deregulation. The task before us is to provide deposit-taking institutions the capacity to compete and serve the public effectively *while minimizing the potentially disruptive consequences of dramatic change.*

Competition and Conditions in the Financial System, *supra*, at 64 (Remarks of John G. Heimann, Comptroller of the Currency of the United States) (emphasis added).

In 1982 Congress reaffirmed and extended its commitment to deregulation in favor of free market competi-

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[5] Accordingly, DIDC was directed to phase out interest rate controls "as rapidly as economic conditions warrant" without exceeding market rates, and with due regard for the "safety and soundness of depository institutions." 1980 Act at § 204, 12 U.S.C. § 3503.

tion for national banks and other financial institutions in the Garn-Saint Germain Act, (the "1982 Act").[6] The 1982 Act, *inter alia*, amended national banking laws in the areas of lending limits, real estate lending and bank borrowing to "allow banks to respond better to changing economic curcumstances and new marketplace competitors," S. Rep. No. 536, 97th Cong., 2d Sess. 25 (1982).[7]

Congress liberalized the lending limit provisions of 12 U.S.C. § 84 to allow banks to be more effective in the competitive marketplace.

> Generally, this amendment is intended to provide smaller national banks with the ability to meet local credit needs *and to compete with less restricted banks and non-bank competitors.* (emphasis added)

Id. at 26. Similarly, Congress simplified the real estate lending authority of national banks to:

> provide national banks with the ability to engage in more creative and flexible financing, *and to become stronger participants in the home financing market.* (emphasis added)

Id. at 27. In addition, Congress removed regulatory constraints on national bank borrowings to provide banks with

> greater flexibility to fund their activity through modern techniques *and to compete more effectively with state chartered banks and less regulated institutions.* (emphasis added)

Id. The 1982 Act also directed DIDC to develop and make available to all financial institutions a new market

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[6] Depository Institutions Amendments of 1982, P.L. 97-320.

[7] *See also Competition and Conditions in the Financial System, supra*, at 31 (1981) (Remarks of Donald T. Regan, Secretary of the Treasury).

rate deposit account that is directly equivalent to and competitive with money market mutual funds. 1982 Act at § 327, 12 U.S.C. § 3593(c)(1). It is apparent that the ability of a national bank to compete effectively in the free marketplace is a clear Congressional objective in both the 1980 and 1982 Acts.

It is also apparent, both in the extensive legislative history on both Acts [8] and as a matter of logic, that the removal of artificial interest rate limitations—*i.e.*, limits on the amount that banks can *pay* for deposits—would also affect the prices that they *charge* for their services. It was, however, the conclusion of Congress and the regulatory agencies charged with overseeing banking policy that deregulation and increased competition among providers of deposit-related services can only redound to the ultimate benefit of the consumers of those services. As early as 1977, the Senate Committee on Banking, Housing and Urban Affairs stated in the context of hearings on interest bearing demand deposit accounts that if all financial institutions were authorized to offer such accounts, "*competition for consumer deposits will be active, and should result in improved quality and variety of consumer financial services.*" S. Rep. No. 407, 95th Cong., 1st Sess. 8 (1977).

These sentiments are echoed and amplified in the recent Senate Hearings:

> Competition to attract deposits, to make loans, and to provide other financial products will encourage the provision of services and information that customers need and are willing to pay for. Competition will not insure perfect results, as measured against some ideal, but neither does regulation. *Competition, itself, may offer results that are acceptable when measured against the cost and imperfect success of governmentally regulated behavior, particularly when*

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[8] *See* footnote 4, *supra.*

> *the benefits of freedom-induced innovation over time are taken into account.*

Competition and Conditions in the Financial System, *supra*, at 55 (Remarks of Frederick H. Schultz, Vice Chairman, Board of Governors of the Federal Reserve System) (emphasis added). At another point, Donald T. Regan, Secretary of the Treasury, stated that: "The ultimate beneficiary of [deregulation] would be the consumer or other user of depository institution services whose special conveniences could be more readily addressed." *Id.* at 33. *See also Competition and Conditions in the Financial System*, *supra*, at 65 ("our present framework is increasingly out of touch with the market realities. Whatever reform occurs elsewhere, the failure to address this issue will assure increasingly inefficient and costly regulation.") (Statement of John G. Heimann, Comptroller of the Currency.)

To impose an artificial limitation on a national bank's deposit-related charges, including NSF service charges, in the face of federally mandated deregulation of interest rate ceilings is not only inconsistent with the federal policy favoring free market competition, but also represents a serious threat to the safety and soundness of national banks.

If national banks are to be able to compete effectively and survive in this deregulated environment, they must be free to set their prices "on a competitive basis," 12 C.F.R. § 7.8000, consistent with sound business judgment, without the interference of *ad hoc* judicial determinations of "reasonableness" under the rubric of "unconscionability."

CONCLUSION

The petition for hearing in this case asks this Court to determine regulatory policy affecting national banks, contrary to the federal policy that free marketplace competition should determine the level of pricing of a national bank's services. Because a hearing in this case would necessarily and inappropriately involve this Court in issues of national bank regulatory policy, the Comptroller urges this Court to deny appellant's petition for a hearing and allow the decision reached in the Court of Appeals to stand.

Respectfully submitted,

Dated: June 20, 1983

COMPTROLLER OF THE CURRENCY
OF THE UNITED STATES

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